

The University of Chicago

THE ASSEMBLING OF MERCHANDISE

A PART OF A DISSERTATION SUBMITTED TO
THE FACULTY OF THE SCHOOL OF BUSINESS
IN CANDIDACY FOR THE DEGREE OF DOCTOR
OF PHILOSOPHY

By
ERNEST F. WITTE

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PURCHASING POLICIES AND PRACTICES
OF CHAIN DRUG COMPANIES



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PREFACE

The idea of operating a number of retail units by a centralized management is not new even though its introduction into this country upon a large scale is so recent that agitation against this form of retail organization has not, as yet, entirely subsided.

The chain-store era in the United States began just previous to 1900, although its great development has come since that time. It is probably correct to say that those who began the movement had no idea that they were creating chain systems which would have the far-reaching economic consequences they have had.

Every one who has given thought to the growth of chain stores has a theory of his own as to the causes which have made their rapid growth possible. Disregarding at this time all but one of the many reasons advanced for the rapid development of chain stores, we may center attention upon the buying advantage, which is almost universally held to be one of the major factors. This buying advantage is ascribed largely to the fact that chain stores buy in larger volume than their independent competitors.

Interest in chain stores, therefore, centers about this important problem of chain-store buying, and for this reason a rather comprehensive examination of all the details relating to the buying policies and practices of drug chains during the period from 1927 to 1930 was undertaken as a part of a larger study which deals with the organization, management, and control of drug stores. This study is confined to drug chains because of their importance in the retail field, and because the amount of work involved made it impractical to undertake a more com-

prehensive study. An attempt is made to examine in detail the various phases of drug chain buying.

Although the present monograph deals only with the purchasing activities of chain drug stores, readers who are interested in any of the subjects listed below are referred to the author's thesis, *Organization, Management and Control of Chain Drug Stores* (University of Chicago, 1932): history of the chain-store movement, selling activities of drug chains, methods used to control the individual drug units, methods used to select drug-store sites, the arrangement and equipment of the chain drug store, employment and training of personnel, operation of chain drug warehouses, handling of traffic functions, internal control of operations through the use of records, statistics of operation, and the financing and earnings of chains.

The data contained in this study were obtained from an intensive investigation of three of the largest drug chains in the country and of one local chain, a co-operative drug organization, and a wholesale drug company. In addition to these sources a number of questionnaires to the trade were used, and a very comprehensive canvass of the literature in the field was made.

In 1928, while this study was still in process, the Buck & Rayner Drug Company of Chicago was taken over by Drug Incorporated, which also controls the L. K. Liggett Company. Since the completion of the major part of the field study in 1929, Drug Incorporated has also purchased the capital stock of the Owl Drug Company of California. This leaves only two, the Walgreen and Liggett drug companies, of the original four drug companies studied in the competitive field. These circumstances do not affect this study in any important way.

I wish to express my sincere appreciation to the many chain-store officials and employees and to the several independent merchants to whom I am indebted for much information, help,

and advice. I want particularly to thank Dean W. H. Spencer of the School of Business for making this study possible, and Professor J. L. Palmer who supervised the work. To Professors E. A. Duddy and W. N. Mitchell thanks are also due for their help and criticism.

ERNEST F. WITTE

CHICAGO, ILL.
January, 1933

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CHAPTER I

SUMMARY AND CONCLUSIONS

The data secured in this study of the buying policies and practices of chain drug companies have led to some rather definite conclusions regarding certain aspects of the subject, namely, *grievances of the independent druggist* relative to his problem of buying, *policies governing chain drug companies in their purchasing activities*, and *chain-drug-store advantages in buying*. The reader should be warned that no attempt is being made here to summarize all of the points discussed in the study itself.

GRIEVANCES OF THE INDEPENDENT DRUGGIST

The independent druggist has several more or less justifiable complaints which he brings against the selling practices and policies of those who supply him with merchandise, as well as against certain buying practices of the drug chains. These include:

1. The policy followed by many manufacturers in according secret discounts to the competitors of the independent druggist, and the policy of the drug chains in demanding such discounts.
2. The demoralizing influence on the trade arising from the suspicion and fear engendered by the granting of secret discounts.
3. The inordinate importance which manufacturers attach to chain-store outlets as compared with independent drug-store outlets.
4. The failure of the wholesaler and manufacturer to protect the independent against destructive price competition.

2 PRACTICES OF CHAIN DRUG COMPANIES

5. The failure of the wholesaler and manufacturer to come to the aid of the independent by actively helping him fight his battles. This charge is particularly aimed at wholesalers whose entire welfare is inseparably bound up with that of their independent clients. It must be added that many wholesalers have been more aggressive, in recent years, in extending aid to their independent drug-store customers than has been true heretofore.

That the independent druggist himself is to blame for a share of these policies and practices against which he complains is not to be denied. But, granting this, it must still be maintained that he is entitled to more consideration from those he complains about than he has been accorded.

POLICIES GOVERNING CHAIN DRUG COMPANIES IN THEIR PURCHASING ACTIVITIES

The more important policies which seem to govern purchasing activities may be briefly summarized as follows:

1. The chains use all the power of their strong position to secure the lowest possible prices.
2. In all possible cases, merchandise is purchased directly from the manufacturer but is ordered from his salesman.
3. All discounts are taken, provided that they are compatible with other chain policies.
4. Only reliable suppliers are dealt with.
5. The manufacturer is made to bear a great part of the marketing risk arising from price fluctuations and in some cases from changes in demand. In many cases the chains refuse to stock merchandise, especially new items, without first making an agreement whereby such merchandise can be returned to the manufacturer if the expected demand does not develop in the time agreed upon.
6. Merchandise is purchased in such quantities as will in-

sure a supply great enough to meet regular requirements, and which will make possible a rapid stock turnover.

7. The closest co-operation is established with the manufacturer in order to secure all possible consideration and to secure his help in demand creation.

8. Drug chains generally refuse to handle merchandise with no well-established demand and not backed by a definitely formulated plan for creating such demand. The drug chains insist that it is the manufacturer's task to create a market for his product before they can afford to handle it.

9. Speculation on commodity prices is not generally practiced.

10. Usually only merchandise of good quality is purchased. By this is meant merchandise which the chain can afford to guarantee and is willing to have associated with its name.

11. Distress or special merchandise is bought, but only under the most favorable conditions and when no reasonable obstacle to its being quickly disposed of is foreseen. A cash fund is sometimes placed at the department's disposal for this purpose.

12. Though the drug chains may be said to favor nationally known brands of commodities because they are more easily sold, there is a distinct tendency toward the purchase of merchandise which the individual chains can control. This tendency is due to keen competitive conditions on national brands which make a legitimate profit on their sale almost impossible.

13. The purchasing department devotes much study and effort to the buying of distinctive sundries merchandise because such merchandise is less competitive and offers the best opportunities for satisfactory profits. Purchasing officials do much pioneer work in this connection. Their ideas for such merchandise are passed on to manufacturers in return for the privilege which the chain receives of being allowed to handle such commodities for a period before they are sold to competitors.

CHAIN-DRUG-STORE ADVANTAGES IN BUYING

The conclusions on the controversy over the advantages enjoyed by drug chains in buying may be briefly summarized in the following points:

1. As nearly as the writer can determine, chain stores when compared with wholesalers receive, in almost all cases, the same or better discounts and terms from suppliers. This gives the chain somewhat of an advantage as compared with the independent merchant, because the chain's warehousing activities cost less than those of the wholesaler, who must charge the independent an additional amount above the original cost of the merchandise to cover his costs and profits.

2. The reasons advanced in this study seem to justify fully the policy of manufacturers in giving the chains sales terms at least equal to those accorded jobbers.

3. It seems fairly well established that many manufacturers, although both they and the chains may deny it, grant so-called secret discounts to chain drug companies, especially to the larger ones.

4. Reasons were advanced, though not proved, which may indicate that the manufacturer is justified in giving additional discounts to the chain, but the secrecy of the method is condemned as being unethical. If the discounts are justified, they should be openly granted.

5. Indications seem to point to the fact that the advantages which supposedly accrue to the chain because of its buying power are, for the most part, exaggerated, even though the discounts secured are of importance.

6. The mere size of an order is not the only factor of importance to the manufacturer when he is considering sales terms. There is a limit beyond which increased volume no longer brings decreased costs, and hence the ability to reduce the price does not always follow an increase in the size of orders. Hence the manufacturer frequently requires additional reasons

besides the size of the order for giving advantageous terms to the buyer.

During the period of this investigation (1927-30) evidence has pointed to the tremendous power exercised by the drug chains over their suppliers. During this period conditions were more than normally favorable to the seller. The present difficulties of sellers in finding markets, therefore, is occasion for interesting speculation regarding the present power of the drug chains. Surely present conditions are likely to make it possible for the chains to exercise even greater influence over suppliers than has ever been true in the past.

CHAPTER II

PURCHASING POLICIES AND PROCEDURES

RESPONSIBILITY FOR PURCHASING POLICIES

It is difficult to place accurately the responsibility for establishing the policies in force in the purchasing departments of chain drug companies. Generally those of first importance are decided upon by major executives who form the merchandising board (or its equivalent). These policies concern:

1. The general classes of commodities to be handled by the stores.
2. The general terms of purchase contracts to be offered suppliers.
3. The authority of the purchasing department with regard to size of orders, period of ordering, contracting for distress merchandise, and the like.
4. The responsibility of the purchasing and sales officials with regard to overstocks or shortages.
5. The relations of the purchasing and sales departments to each other.
6. The authority of the store managers in making purchases direct from suppliers (or otherwise) of merchandise not on the standard store lists as supplied by the purchasing department.

This enumeration of the policies considered and prescribed by the major officials under which the purchasing department operates cannot be said to give a complete digest of the relationship between the major executives and the department, since even the most trivial affairs may be considered and prescribed for by the merchandise board or its equivalent. Questions of administrative policy or practice ordinarily left to the purchasing-department officials may, of course, as for any other

department, be considered by the board, especially on complaint from some other department. In most cases the department, working under the general policies laid down for it, will work out its own internal policies, rules, and procedures, as, for example:

1. The procedure for placing an order.
2. The method of stock-keeping.
3. The responsibility of the buyers for signing orders.
4. The technique of selecting merchandise.
5. Methods of testing.
6. Size of orders.
7. Price limits and stock requirements (within classes) of commodities handled.

The buying department, though having considerable authority in selecting commodities, in making terms with suppliers, and in departmental procedure, does not have unlimited authority and is, as a matter of fact, operating within rather fixed limits laid down by major officials, to whose scrutiny all its acts are subject. Final responsibility for results in the department rests with the head of the department in all cases, despite any restrictions which may be placed upon him.

FORECASTING THE MARKET

In purchasing such large quantities of merchandise it might be thought that the drug chains would run great danger of loss through fluctuating market values. As a matter of fact, this possibility has probably been reduced by the chains more than by any other agents engaged in marketing activities.

In the first place, retail prices usually fluctuate less rapidly than wholesale prices, and since the drug chains buy only for short periods in advance, the possibility of disposing of merchandise before a change in price is greater than it might otherwise be. Yet in the drug trade the very presence of the chain stores has made retail prices exceedingly sensitive to changes in

wholesale prices, especially when the trend is downward. The policy of some drug chains is to reduce retail prices as soon as wholesale prices are reduced rather than to wait until stocks on hand are exhausted (and in a competitive market this means that all drug chains must do the same), whereas in a rising market prices are not advanced on competitive goods until it is necessary to purchase additional stock, for the drug chains, like other retailers, are generally reluctant to raise prices.

In the second place, the drug chains have succeeded most remarkably in getting the manufacturer to bear the market risks caused by fluctuating prices. The purchasing contract usually calls for the manufacturer to guarantee to the chain that if after an order has been placed prices fall, the manufacturer will refund the difference between the original purchase price and the new price. In most instances this refund is made on merchandise still in the chain's warehouses, but sometimes on undelivered goods only. On the other hand, if prices rise after the chain has placed its order, the manufacturer agrees to bear the loss.¹

Two reasons are advanced as to why manufacturers are willing to assume these risks. First, they are so anxious to secure the chain's business that this concession offered by one manufacturer is necessarily offered by competitors who hope to retain or secure a part of the business. Second, such a guaranty induces the chain to order in advance, and in larger quantities than usual. This enables the manufacturer to plan his production more satisfactorily.

For these reasons it is apparent that, as far as protecting itself against price fluctuations in the regular course of its retail business, the drug chain is not greatly concerned with the forecasting of market conditions and prices, except as they aid in formulating estimates of sales volume. But there are two other

¹ The manufacturer may not bear the risk, of course, if he has hedged, or has purchased his raw materials at the time of the contract.

situations which may justify an attempt to forecast prices: (1) most drug chains are engaged in some manufacturing and the raw materials necessary are subject to violent price fluctuations against which the chain is not usually protected; (2) there is also the possibility of making profits by buying in large quantities before a rise in price.

Those chain drug companies which find it necessary to buy quantities of raw materials for their own manufacturing establishments attempt to forecast the market. Sometimes, as in the case of the Liggett Company, where the head purchasing official also directs the purchasing for the United Drug Company, this involves a study of world-market conditions. In this company the vice-president in charge of purchasing devotes much of his time to the study of market factors and conditions in an effort to forecast the prices of raw commodities, such as rubber and sugar, often for two years in advance, though supplies are rarely purchased for a longer period than ninety days in advance.² The foreign as well as the domestic situation is involved in the purchase of certain oils and essences used in the manufacture of perfume and toilet goods. Aside from the

² Two examples were cited by the purchasing agent to illustrate this work. Sugar prices had been forecast for some time in advance. At the time of the interview they had reached their lowest point, being below the cost of production. The department was buying only enough sugar to meet day-to-day needs because prices were expected to fall to even lower levels. It was assumed, however, that the bottom would be reached shortly and preparations were being made to buy large supplies. In addition, the company hoped to get the refiner or broker to guarantee them against further declines after the purchase on the undelivered part of the order. It is usually difficult to get such price guaranties on raw products.

In the second case, the price of raw rubber, which the company's factories use in great quantities, was predicted for long periods in advance, and on the strength of this forecast the company purchased large supplies. As predicted, raw-rubber prices soared and the company had offers for its purchase contracts which would have yielded profits of approximately \$480,000, but all offers were refused because the profits to be realized from the manufactured products were greater. In addition, this supply was needed to keep its factories going.

United Drug Company (Liggett Drug Company), the manufacturing activities of which are very extensive, few of the chain buyers attempt any thorough study of conditions for purposes of price-forecasting. They depend largely upon their personal judgment, formulated by their knowledge of general business conditions and special factors which may influence the price of a particular commodity. This information may be secured from trade journals and business-forecasting services.

The question arises, of course, as to whether the purchasing department ought to engage in buying activities for the purpose of making speculative profits. Beckman says:

Speculation is one of the functions in which a wholesaler is well prepared to delve so long as his organization is efficient, and large profits may be missed when buying is confined to small quantities. In fact, one of the important functions of a wholesaler is to store goods in large quantities and assume risks incident thereto.³

It is true that this statement concerns wholesalers, but, since the chain is also a wholesaler, and since its purchasing department is usually very efficient, the statement might as readily be applied to the chain.

Mr. J. O. McKinsey⁴ says, on the other hand, that it is not the business of the purchasing agent to attempt to forecast prices in an effort to make speculative profits. This activity is not a legitimate part of the marketing function and is likely to cause losses instead of profits. He maintains that a purchasing agent is not qualified to do this kind of work or, if he is, he should be working on the stock or commodity exchanges, where such activities are proper.

On this same subject W. N. Mitchell says:

The dangers of such a policy [speculation] are obvious. The buyer's attention tends to be focused upon the market rather than upon the work

³ T. N. Beckman, *Wholesaling* (New York: Ronald Press, 1926), p. 207.

⁴ Professor of business organization in the University of Chicago.

of buying only enough to satisfy the reasonable requirements of the business. Overinvestment in inventories results and frequently where speculative policies are countenanced, little is done to count the costs of such investments. When the period of prosperity is finally passed and a general stock-taking becomes necessary in order to initiate operating economies, the real significance of these becomes apparent. Almost unbelievable inconsistencies sometimes come to light during such an investigation.⁵

In the main, purchasing agents agree with this last contention. Sometimes information available is so reliable that future price movements are easily predictable, and in such cases buyers usually so act as to profit thereby. One of the purchasing agents of the Owl Drug Company believes that a study of price trends has enabled him to make large profits for his company by purchasing at the proper time. When he is sure that there will be a period of rising prices, he stocks more heavily than usual, but in no case more than a year's supply. This agent studied the government report on cotton-crop conditions at one period and concluded that cotton prices were sure to advance. Accordingly, he contracted for a year's supply of wash cloths and other cotton products which were then stored and sold to the stores on demand. On this one transaction the agent claims to have saved the company more than his year's salary. Before contracting for the stock, interest on the investment was figured at 10 per cent and the cost of storing was computed, so that final cost would not total more than the saving that was effected by purchasing before the advance in price.

Another aspect of price-forecasting is involved in the purchase of special or distress merchandise. Sometimes the opportunity arises to make purchases of large quantities of goods, more than is needed for current operations, if an immediate

⁵ *Purchasing* ("Bus. Adm. Ser."; New York: Ronald Press, 1927), pp. 274-75.

cash payment is made for the total quantity.⁶ But in such cases it is important that the buyer consider whether the merchandise can be sold before it becomes obsolete, whether interest and storage costs will offset any saving in price, and whether the trend of the price of this commodity is likely to be downward in the near future. In other words, such transactions also call for some forecasting of market conditions.⁷

PROCEDURES USED IN MAKING A PURCHASE

The four chains studied use somewhat different procedures in making routine purchases. It hardly seems worth while to detail each of the four methods. Purchase orders generally go through a routine such as the following:

1. Stocks are inspected and counted at periodic intervals, the record of movements being kept in a semiperpetual inventory file.

2. When records indicate that stock on hand, judged by present rate of movement from the warehouse, is at a minimum point, the inventory or stock clerk prepares an order (or notifies the proper person) for the item, the amount ordered being based on present sales volume, maximum discount rates on orders of certain sizes, freight considerations, seasonal factors, warehouse space, and personal judgment.

3. The order goes to the buyer in whose jurisdiction that merchandise belongs. If the order meets with his approval, he

⁶ In this connection it might be noted that many concerns maintain a cash fund for the purchasing department, available at all times for use in picking up distress merchandise or special offers. The managing director of the Buck & Rayner Company claimed that he could secure exceptional bargains if he displayed ready cash when purchasing commodities.

⁷ E.g., in the Chicago Owl warehouse it was noted that there was a large number of electric fans which retail at nearly \$10, which added heavily to capital tied up in inventory. On being questioned about these fans the purchasing agent said that he had been able to purchase a large supply below the cost of manufacture and had done so, figuring that he could hold them for a long time and still make a good profit on them.

signs it and sends it to the chief purchasing agent. This official may change the terms of the order in accordance with later information which he may possess.

4. The purchasing agent then has the order typed in triplicate with such additional instructions as he may have and signs the order, one copy going to the supplier, one to the warehouse, and a third to the purchasing-department files.

The procedure in ordering new goods is somewhat different. Most new merchandise is brought to the attention of the purchasing department by salesmen of the manufacturing company, who are usually particularly anxious to get their new goods introduced into chain drug stores. Everything from automobile parts to women's clothes is brought to the purchasing department of the drug chains, in the hope that the merchandise will be sold through the drug store. It is rarely necessary for the department to seek new items, but this sometimes happens, and the department is constantly watching for new items not brought to its attention in the regular ways. So many articles are continually being suggested that it becomes impossible for the head buyer to look at all of them, and yet new goods and novelties are so important to the maintenance of the chain-drug-store volume that no item is turned away without first being inspected. The usual procedure is to have the salesman with a new product interviewed by one of the buyers. This buyer secures all the information possible about the product, the terms of sale, what volume the manufacturer is doing, to what extent he is prepared to help the chain sell the merchandise, and other pertinent information. If the buyer is sure that the article is unsuited to the company's business, he may close the subject by telling the salesman so. If he thinks that the commodity has merit, he submits a sample with recommendations to the head buyer, who usually makes the final decision, often consulting sales officials before taking action. In the Liggett Company the information and sample are sent by the

buyer to the sales department for inspection; the vice-president in charge of purchasing may or may not be consulted by the buyer before his recommendation to the sales department is made; the buyer's action depends upon how sure he is of his own judgment. The Owl Drug Company gives the salesman the chance of appealing from the decision of the purchasing agent by going to the general manager or vice-president. Sometimes these officials decide to allow the company to stock articles which the purchasing agent had refused, in which case they assume the responsibility.

CHAPTER III

SOURCES OF SUPPLY

THE SOURCES OF CHAIN PURCHASES

It is common knowledge that chain stores of all kinds purchase the vast majority of their merchandise directly from the manufacturers. The right to do this has long been bitterly contested, but nearly all manufacturers have finally conceded that right.¹ Chains also manufacture part of what they sell, though the ratio of sales of their own goods to total sales is still rather small. Wholesalers or jobbers are still used by chain drug companies under such conditions as the following:

1. In emergencies.
2. In buying items the sales volume of which is small.
3. In case a "full line" buy is necessary from the manufacturer, and is not advisable from the standpoint of the chain.
4. Where merchandise can be obtained only from the wholesaler.

The drug chains usually make arrangements with local jobbers in the cities in which they operate to supply their units whenever they order. Thus, when the chain unit has exhausted its supply of an item and delay in shipping from the company's warehouse is unavoidable, the stores are usually authorized to order from a specified jobber. In some cases the sales volume of certain items is so small that the chain can make no saving by buying direct. Sometimes manufacturers specify that the complete line (say of toilet goods) must be ordered whenever any item in the line is wanted if additional discounts are to be given. Very often one item in the line will sell faster than the rest, and rather than order the whole line and so create a sur-

¹ Cf. F. S. Hayward and P. White, *Chain Stores* (3d ed.; New York: McGraw-Hill, 1929), chap. viii.

plus of certain stock carried, the chain will order the one item from the wholesaler. This practice on the part of manufacturers is becoming less and less common, especially as the chains grow stronger.² There are a few companies which still refuse to sell directly, and items of such companies are purchased from wholesalers; however, manufacturers who will not sell directly to chains are so rare as to be a novelty today. This was not true in 1927. According to a study made by the Association of National Advertisers at that time, out of 66 responses from members, 60.3 per cent stated that they sold branded merchandise to syndicates, chain stores, and mail-order houses. Of the 60.3 per cent, 87.5 per cent sell their branded merchandise to chain stores. It is possible that those companies refusing to sell their national brands direct to the chains were selling them their unbranded merchandise.

Drug chains, it was reported in 1924, purchased less than one-fifth of their merchandise from the jobber, while the average independent drug store bought approximately 60 per cent of its needs from this source.³ The results of this early study are presented in Table I. A second study of the sources of drug-chain merchandise was reported the following year, the results of which are shown in Table II for comparative purposes.

The most recent comprehensive study of the sources from which drug chains purchase the commodities they retail is that made by the Federal Trade Commission.⁴ In summary this report, which is for the year 1928, shows:

² The Liggett Company maintains that it has not encountered trouble of this nature, but the Walgreen, the Owl, and the Buck & Rayner companies have reported difficulties. The Walgreen Company helped to organize the Federated Drug Company, one of its purposes being to secure merchandise directly from manufacturers who refused to sell to the chain.

³ W. H. Mullen, "Some Aspects of Chain Store Development," *Harvard Business Review*, III, No. 1 (October, 1924), 69 ff.

⁴ *Chain Stores: Sources of Chain-Store Merchandise* (72d Congr., 1st sess., Senate Doc. 30, submitted December 22, 1931; Washington, D.C., 1932).

TABLE I*
PERCENTAGE OF TOTAL SUPPLY OF SPECIFIED PRODUCTS PURCHASED FROM MIDDLEMEN BY CHAIN DRUG COMPANIES

Item	Number of Chains Reporting	Under 10%	10-20 %	20-30 %	30-40 %	40-50 %	50-60 %	60-70 %	70-80 %	80-90 %	90% or Over
Toys and novelties.....	3	3	.....	.....	.....	.....	.....	.....	.....	.....	.....
Household goods.....	4	2	1	1	.....	.....	.....	.....	.....	.....	.....
Stationery.....	4	2	.....	2	.....	.....	.....	.....	.....	.....	.....
Rubber goods.....	4	2	.....	2	.....	.....	.....	.....	.....	.....	.....
Medicine.....	5	1	1	3	.....	.....	.....	.....	.....	.....	.....
Toilet articles.....	5	1	3	.....	.....	.....	.....	.....	.....	.....	.....
Cigars and tobacco.....	3	1	.....	1	.....	.....	I	.....	.....	I	.....
Drugs and chemicals.....	4	1	.....	.....	.....	.....	.....	.....	I	.....	.....
Food articles.....	5	2	.....	.....	.....	.....	.....	.....	.....	.....	.....
Candy and confectionery.....	4	1	.....	2	.....	.....	.....	.....	.....	.....	I

* Taken from W. H. Mullen's report, "Some Aspects of Chain Store Development," *Harvard Business Review*, III, No. 1 (October, 1924), 60 ff.

TABLE II*
SOURCES OF SUPPLY OF EIGHT DRUG CHAINS

ITEM	PERCENTAGE OF TOTAL THUS PURCHASED																				
	NUMBER OF CHAINS REPORTING		UN- DER 10%	10- 20%		20-30%		30-40%		40-50%		50-60%		60-70%		70-80%		80-90%		90-100%	
	M	W	M	W	M	W	M	W	M	W	M	W	M	W	M	W	M	W	M	W	
Drugs and chemicals...	6	4	I	I	I	I	...	...	...	...	...	...	I	...	...	...	...	...	4	...	
Medicines...	6	5	I	I	...	3	...	...	...	...	...	...	I	...	...	...	...	...	2	...	
Toilet articles...	6	5	I	3	...	...	...	...	I	...	2	...	...	...	I	...	...	...	3	...	
Rubber goods...	6	4	2	2	...	...	...	...	...	...	...	...	...	...	2	...	...	...	4	...	
Household goods...	6	4	2	I	...	I	...	...	...	...	...	...	...	...	I	...	...	...	4	...	
Toys and novelties...	5	3	3	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	5	...	
Cigars...	6	3	I	I	I	...	...	...	...	...	...	...	...	...	I	...	...	...	4	...	
Candies...	5	4	I	...	...	2	...	...	...	...	...	...	...	...	I	...	...	...	3	I	
Food products...	6	5	2	...	I	2	...	...	...	...	I	...	I	...	I	...	...	...	2	...	
Stationery...	6	4	2	...	...	2	...	...	...	...	...	...	...	...	I	...	...	...	4	...	

M indicates purchases from manufacturers; W indicates purchases from wholesalers.

* Taken from L. W. Lohr, *Methods and Policies in Chain Drug Store Merchandising Used by the Walgreen Company* (Master's thesis, Northwestern University, May 16, 1925), p. 106.

Of 132 drug chains reporting, 121, or 91.7 per cent, purchased from manufacturers; 7, or 5.3 per cent, from growers; 15, or 11.4 per cent, from brokers; 132, or 100 per cent, from wholesalers; 10, or 7.6 per cent, from other sources.⁵

Drug chains reported that 78.3 of their purchases came from manufacturers and 20.4 per cent from wholesalers.⁶ The remaining 1.2 per cent came from brokers, growers, and other sources.⁷

Drug chains stood eleventh among the chains listed in percentage of purchases made directly from manufacturers (78.3 per cent) and nineteenth in the percentage of gross profit earned.⁸ According to this report, the proportion of the total goods purchased directly from manufacturers by drug chains varies according to the number of stores in the chain. The data indicate that drug, tobacco, hardware, and musical-instruments chains (grouped together in the report) having from 2 to 5 stores purchased 39.5 per cent from manufacturers; chains of 6 to 10 stores, 53.8 per cent; chains of 11 to 25 stores, 76.6 per cent; chains of 26 to 50 stores, 73.0 per cent; chains of 51 to 100 stores, 91.9 per cent; chains of 101 to 500 stores, 77.2 per cent; chains of 501 to 1,000 stores, 95.2 per cent; and chains of 1,000 and more stores, 95.1 per cent.⁹

The trend in the proportion of goods purchased from manufacturers by drug chains is indicated in the following data for the years 1922 and 1928. Sixty-four chains reported. They had 480 stores in 1922, or an average of 7.5 stores per chain. They purchased 83.6 per cent of their total supply from manufacturers, 15.9 per cent from wholesalers, and 0.5 per cent from other sources. In 1928 these same chains had 901 stores or an average of 14.1 stores per chain. They purchased 87.3 per cent

⁵ *Ibid.*, p. 8, Table II.

⁶ *Ibid.*, p. 12, Table IV.

⁷ *Ibid.*, p. 13, Table V.

⁸ *Ibid.*, p. 20, Table VIII.

⁹ *Ibid.*, p. 28, Table IX.

from manufacturers, 12.1 from wholesalers, and 0.6 per cent from other sources.¹⁰

The proportion of drug-chain purchases from manufacturers varies according to their geographical location. Twenty drug, tobacco, hardware, and musical-instruments chains in New England purchased 67.1 per cent of their supplies from manufacturers; 40 Middle Atlantic chains, 65.5 per cent; 47 east

TABLE III*
SOURCES OF SUPPLY FOR SPECIFIED PRODUCTS PURCHASED
BY CHAIN DRUG COMPANIES

COMMODITY	NO. OF REPORTS	ALL CHAINS	
		Per Cent Purchased From	
		Manufacturers	Wholesalers
Photographic supplies	15	83.4	10.3
Stationery	26	69.8	30.2
Candy and confectionery	64	68.0	32.0
Rubber goods	22	67.6	32.4
Hospital supplies	19	63.0	37.0
Toilet articles	84	56.9	42.5
Fountain and lunch	69	55.0	44.1
Drugs	134	40.0	58.4
Sundries	62	33.2	66.2
Proprietaries	68	33.5	65.7
Tobacco products	86	18.6	80.6

* 72d Congr., 1st sess., *Senate Doc. 30*, p. 54, Table XXIV.

north central chains, 55.4; 23 west north central chains, 41.2 per cent; 11 South Atlantic chains, 67.3 per cent; 14 west south central chains, 40.6 per cent; 10 mountain chains, 64.8 per cent; 26 Pacific chains, 48.7 per cent.¹¹

The sources from which certain individual drug-store items are purchased are shown in Table III.

The data showing the affiliation of drug chains with actual or potential sources of supply indicate that 2 chains having 678 stores were owned in whole or in part by manufacturers in

¹⁰ *Ibid.*, p. 34, Table XV.

¹¹ *Ibid.*, p. 44, Table XX.

1930; 2 chains with 13 stores were owned in whole or in part by wholesalers in 1928; 6 chains with 117 stores held memberships in wholesaler co-operative associations in 1928; 7 chains with 26 stores purchased from co-operative wholesaler associations in 1928.¹²

The Buck & Rayner Company estimated that 75 per cent of its total purchases were made directly from the manufacturer, 10 per cent from a co-operative buying organization to which it belonged, while the remaining 15 per cent came from its own laboratories and from wholesalers.

The Owl Drug Company estimates that only about $2\frac{1}{2}$ per cent of its total purchases come from wholesalers, the remainder coming from its own laboratories and directly from manufacturers. The company estimates that it either manufactures or controls the manufacture of 20 per cent of the volume it sells.

Lohr states that in 1925 the Walgreen Company, out of an estimated 14,000 items carried in stock, purchased 70 per cent directly from the manufacturer, but that 94 per cent of the company's volume was done on this 70 per cent of the items. The remaining 30 per cent of the items were purchased from jobbers, but only 5 per cent of the total volume was done on such merchandise.¹³

Walgreen officials state that at present something less than 94 per cent of the company's volume is done on goods purchased from manufacturers and about 5 per cent is done on the company's own manufactured products.

The Liggett Company estimates that it purchases almost 90 per cent of its total volume directly from manufacturers. This company is affiliated with several other concerns, some of recent acquisition, so that it probably does something more than from 16 to 18 per cent of its sales volume on goods manufactured under its own control or by affiliated companies. Only a

¹² *Ibid.*, Appen. II, p. 67, Table I.

¹³ Lohr, *op. cit.*, pp. 105-6.

very small percentage of the total volume, averaging from 2 to 4 per cent, is done on goods purchased from jobbers.

There are many reasons why chains purchase directly from manufacturers in all possible cases. They are briefly:

1. Manufacturers offer better prices. The chain can usually secure prices as good as or better than the jobber can secure, and believes that it is entitled to them.

2. Manufacturers offer more complete co-operation. Officials of the four drug chains studied were almost unanimous in their agreement on this point. Wholesalers and jobbers, with a few outstanding exceptions, have made no intelligent efforts to supply service which would be of any value to a chain organization. They have failed to change their services to meet changes in the marketing processes and hence have been ignored. Many have not even rallied to the aid of independent druggists, much as they depend on them for the bulk of their trade.

3. Manufacturers maintain more complete stocks. It has often been the experience of chain companies that wholesalers do not keep enough stock on hand to supply them with even one order. This delays delivery and may well cause the chain large losses in sales.

Mr. D. C. Keller, former president of the Dow Drug Company and the Associated Chain Drug Stores, is worth quoting in this connection. He says:

... It is a fact that the jobber as he is to-day organized is unable to serve the chain store, because of a complete failure of equipment, and because his stock does not sufficiently coincide in character or extent with that of the chain store operator, who not infrequently, but usually, carries a stock greater than that of his covetous jobber. This, of course, entails an expense which (though I have not the exact figures at hand) no doubt approximates the jobber's cost of doing business. An article in a recent radical trade journal asserted that chain drug stores passed on their discounts to their patrons through cut prices and magnanimously suggested that the chain stores "ought to keep it themselves." It is beyond the in-

tellectual powers, no doubt, of this writer to understand that the chain stores can do neither of these things for the reason that these discounts, much less in volume at that than the jobber's, are used to provide for the chain itself, the very thing which the jobber cannot. There is not a jobber in the country who can or would give to even a medium-sized chain the service which is required for its success. I know of a recent instance where a manufacturer "broke" an advertising campaign in a certain city without proper arrangement with the city's dominant chain drug stores, though the jobber had been fixed up. The chain stores acting on the principle of meeting demands and magnanimously ordering from the jobber twenty gross, found the jobber with six dozen on hand, or said to have been on hand. Of course the advertising was a failure. The chain's first order to the jobber was probably four times the jobber's purchase.

A certain manufacturer recently conducted two intensive campaigns, as experiments in two cities of about equal size. In the first were 165 dealers reached through the jobber. Four thousand dollars was spent on the campaign with a net sale of fourteen hundred packages. In the other city the same deal was offered through a chain system of about twelve stores. Less than \$1,000 was spent on the campaign and the net sale was over five thousand packages. This manufacturer is now making his introductions exclusively through chain stores where possible.¹⁴

4. Manufacturers help chains solve their problems. The manufacturer can often help the chain in the solution of problems which have proved difficult.¹⁵

The tendency for drug chains to buy directly is so strong and has already gone so far that it is not likely that the wholesale druggist will ever be a large factor in the chain process of marketing. The tendency in recent years has been toward the sale

¹⁴ In an address before the Proprietary Association at Atlantic City (May 10, 1927).

¹⁵ It is interesting to learn what one drug-chain official considers co-operation by the manufacturer to be. The assistant manager and head buyer for the former Buck & Rayner Company stated that manufacturer co-operation included: (1) granting quantity prices, (2) giving return privileges for new goods which do not sell, (3) giving guaranties against loss to the chain in case of price changes, (4) giving the chain special prices for special occasions, (5) shipping and packing according to chain specification, (6) extending the discount period on new merchandise, (7) aiding in creating demand, and in many other ways helping the chain after the order is placed. On the other hand, he said, the wholesaler takes the order and money and does nothing more to justify his higher prices.

from manufacturers directly to independents in many instances, so that it is improbable that the wholesale druggist will ever be as important as he once was. This does not mean that the wholesale druggist will completely disappear. As long as there are independent drug stores—and this will be for a long time—there will be a need for the wholesaler. In the future there will doubtless be fewer wholesale establishments, but they will be larger, more aggressive, and more modern in the services rendered.¹⁶

There may be a tendency on the part of manufacturers at the present time to co-operate more fully with the wholesalers and with independent retailers than has been the case in the immediate past.¹⁷ Supposedly this has been due to a realization on the part of manufacturers that chain drug stores are not going to do all the business after all, and also to the fact that the independent is the only bulwark that the manufacturer has against the arrogant domination of the chains themselves. This seems only natural reaction, if such a movement is actually taking place, for manufacturers have gone almost the whole way in co-operating with chain drug companies, in many ways to their own detriment.¹⁸

MANUFACTURING ACTIVITIES

Although the manufacturing activities of the drug chains are not a primary part of this investigation, they are so closely interwoven with other chain activities that it seems impossible

¹⁶ This tendency is already in evidence. Fifteen of the leading drug wholesalers recently merged into a huge organization, a sort of wholesale drug chain with units scattered over the country under the name of McKesson & Robbins Wholesale Drug Company, Inc. Many of the merging wholesalers are very progressive, furnishing the independent with services which help him to compete successfully with chains. See "\$100,000,000 Merger of Wholesale Houses," *Drug Trade News*, III, No. 17 (August 18, 1929), 1.

¹⁷ According to an official of the Fuller-Morrisson Company.

¹⁸ Cf. Converse, *Marketing Methods and Policies* (rev. ed.; New York: Prentice-Hall, 1924), p. 218, and Hayward and White, *op. cit.*, p. 50.

to avoid some brief discussion of them in connection with the sources of supply for the commodities retailed by the units.

The Owl and the Liggett drug companies carry on all manufacturing enterprises through subsidiary or affiliated corporations. The Liggett Company is, of course, a subsidiary of a manufacturing company since it was organized some time after the United Drug Company and is owned by it. The Owl Drug Company has two subsidiary manufacturing corporations which it owns and controls.

The Buck & Rayner and the Walgreen companies manufacture their products in laboratories owned and operated by the parent-company, but also own subsidiaries which manufacture some of the products retailed by the parent-companies. The most important Walgreen subsidiary is the Valentine Laboratories, Inc., of Chicago, which manufactures a large number of drug products and sundries for Walgreen stores and for sale to the general trade as well. The Walgreen Company does not generally advertise the fact that it owns the Valentine Laboratories because it is believed that such knowledge might injure the sale of Valentine products to other companies. The Century Products Company, subsidiary of the Buck & Rayner Company, would not sell its products to other than Buck & Rayner stores except under special arrangements.

For the most part, the organization of the manufacturing subsidiary (or department) is exceedingly simple, since the manufacturing processes themselves are very elementary. Its organization may consist of a manager or foreman at the head of laboratory activities who is usually a chemist or laboratory specialist. To aid him is an assistant and the factory employees. This is all the organization needed since the purchasing of raw supplies is made by the chain's purchasing department and the factory output is taken by the company's stores.¹⁹ Financ-

¹⁹ The Liggett Drug Company is an exception to organizations of this type. This company is a subsidiary of a manufacturing parent-company, the United

ing and accounting are also handled by the proper chain headquarters departments.

It may be stated with little qualification that the chain purchasing department exercises almost complete authority over laboratory activities. The Walgreen Company, for example, has a purchasing agent specifically assigned to the work of directing manufacturing activities. This department usually determines what products are to be manufactured and in what quantities. It consults the sales department (in companies where the two departments are distinct) regarding the kind of products to be manufactured. The purchasing department may, because of its enthusiastic desire to control its products and sources of supply or because manufacturing appears to be an easy solution to buying difficulties, launch the chain into manufacturing operations for which there is little justification. Such a policy may lead to difficult management problems.

Only one prominent drug chain, the Liggett Drug Company, has been developed by a drug-manufacturing concern. In other companies manufacturing has grown out of the retail business. According to purchasing officials, there are several reasons why the chains have found it desirable to manufacture.

1. *Profits*.—Manufacturing gives the chain a chance to secure additional profits without a corresponding increase in the risks of business. The percentage of profit to be obtained from the manufacture of certain toilet and proprietary products is enormous. One of the chief items of cost included in the retail

Drug Company, which has several large manufacturing plants. In this case the two concerns are almost entirely separate organizations, for although a vice-president in charge of purchases directs the buying of both companies, he does so through a separate group of buyers in each case. There are other close connections, such as financing, which are handled by the same officials for both companies, but the relationships of subsidiary organizations are outside the present study and touched upon only when necessary to make certain drug-chain activities clear. The Walgreen Company and the Valentine Laboratories are also in a relationship different from that described above.

sale price of such commodities is the marketing expense—an expense which the chain reduces to a minimum. The chances for such profits have in most cases proved irresistible; hence, most drug chains manufacture a part of their supply. Generally the manufacturing division of the company is not allowed to make large profits, the goods being sold to the stores at a fixed percentage above cost. Profits are thus credited to the stores.

Another factor which makes the chain's own manufactured goods profitable to handle is the possibility that exists for controlling their resale price. Direct competition is not encountered in the sale of this merchandise and a price (other factors remaining constant) may be established and maintained which will yield a satisfactory profit. In a confidential report made to a client by the Chain Store Research Bureau is the following excerpt:

It is our belief that the leading successful drug chains of the country are successful because of the fact that they take a manufacturer's profits as well as a retailer's on a large percentage of the merchandise sold through their outlets. We further believe that a system of twenty stores could successfully operate its own central manufacturing plant and for that reason it is especially important that you should know exactly what the leading chains in the country are doing as regards the development and manufacture of private brands.

The data in Table IV is indicative of the profits obtained by one chain from the sale of its manufactured products. These data are for 1928, and are probably representative for that period.

2. *Simplicity of manufacturing operations.*—The simple process involved in manufacturing some of the most profitable merchandise is one very important reason why the chain has been able to engage in this activity. Some of the operations which are classed as manufacturing are little more than packaging and labeling operations on which large profits can often be made, as in the case of bottling bulk alcohol. Since the drug

chains have wisely confined their manufacturing to those products requiring very simple processing, this factor alone has

TABLE IV
COST AND RETAIL SELLING PRICES, AND PERCENTAGE OF GROSS PROFIT
OF SPECIFIED ITEMS MANUFACTURED BY THE
"X" COMPANY IN 1928

Items*	Cost to Stores†	Selling Price	Per Cent Gross Profit to Sales Ratio Obtained by Stores‡
Alum powder (4 oz.).....	\$0.07	\$0.15	53.3
Bay rum (8 oz.).....	0.17	0.45	62.2
Bay rum (gall.).....	1.50	2.50	40.0
Beef, iron, wine tonic (qt.).....	0.84	1.60	50.2
Boric-acid powder (2 oz.).....	.04	0.10	60.0
Camphorated oil (2 oz.).....	.10	.25	60.0
Castor oil (3 oz.).....	.10	.25	60.0
Cough-syrup malt (10 oz.).....	.40	.89	55.0
Fly Deth (½ pt.).....	0.18	0.39	53.8
Fly Deth (gal.).....	1.12	2.50	55.2
Glycerin and rosewater (3 oz.).....	0.09	0.25	64.0
Rubbing alcohol (16 oz.).....	.25	0.59	57.5
Success blood mixture.....	.50	1.00	50.0
Success vermin-destroyer.....	.13	0.35	62.8
Vanilla extract (2 oz.).....	0.13	0.25	48.0
Witch hazel (gal.).....	1.65	2.98	44.6
All-purpose talc.....	0.15	0.33	54.5
Perf. cold cream (2 oz.).....	.13	.30	56.6
After-shaving lotion.....	.15	.35	57.1
Lullaby talc (baby).....	.09	.20	55.0
Perf. nail polish.....	.10	.25	60.0
Sweet Me tubes.....	.13	.25	48.0
Toilet water (violet).....	.25	.69	63.7
Bath crystals (8 oz.).....	.19	.42	54.7
Lipstick (large).....	.31	.60	55.0
Sachet.....	.22½	.50	55.0
Soap.....	.12	.25	52.0
Rouge (poppy).....	.22½	.50	55.0
Rouge refill (poppy).....	.12	0.25	52.0
La Peggie toilet water.....	0.79	1.75	54.8

* Samples picked at random from catalogue.

† Cost of goods to stores was known; from each cost figure was deducted the average added by the laboratory to the actual cost price. This is not accurate in every case but is an approximation.

‡ This percentage is fixed on the basis of sales price rather than cost price. It should be noted that an average of 16½ per cent of the cost to the store's price shown above is additional gross profit taken by the laboratory and 3½ per cent is a warehousing charge covering warehouse expenses, so that in reality the company is earning a somewhat larger gross profit than is indicated by the ratio of gross profit to sales as shown in col. 3.

eliminated most of the problems which manufacturers of products requiring more intricate processes have to meet. For this reason it has not been difficult for the drug chain to secure executives competent to direct the manufacturing activities. Moreover, these executives relieve chain officials of the necessity of devoting much time to this phase of the business. Again, no heavy outlay of capital has been necessary since rather simple mixing and bottling machinery is all that is required for the majority of products selected for manufacture.

3. *An assured market.*—This is one of the important reasons why the chain can and does engage in manufacturing. Because the chain is in control of its outlets, it is sure of being able to push a large quantity of its own products into the trade though, in relation to total sales, the amount is usually rather small.²⁰ Furthermore, the advertising of manufacturers of competing products is a great aid in creating a demand for the chain's products at no cost to the chain.

4. *Inability to secure a satisfactory supply of a commodity.*—Sometimes the chain manufactures a product for which it has not been able to locate a satisfactory source. This may be due to an inability to get the commodity at the desired price and in the required quantity. Sometimes the manufacturer is a fly-by-night with whom the chain does not wish to deal because it is not certain that such firms will be able to carry out their contracts. Also, when the chain does the manufacturing the source of supply is controlled and no question arises as to getting the products at the right time and in the amounts wanted.

5. *To improve quality.*—Another reason advanced by the chains for engaging in manufacturing is the necessity of improving and controlling the products which they sell. This reason can be largely discounted, but the products manufactured are said to be of equal quality with those of other producers. Chain chemists assert that chemical tests often show that the

²⁰ See pp. 33 and 34.

goods manufactured by their company are superior in quality to those manufactured by others which sell at a higher price.

6. *Prestige*.—The prestige which products of their own production is thought to give the chains is another reason for their manufacturing activities. The vanity of officials is appeased and customers are likely to be favorably impressed with the size and importance of a concern having its own branded products. It is reasonable for the customer to suppose that the chain will back its own products to a greater extent than it will those of its suppliers.

In addition to producing a part of the products sold through its units, the drug chains handle items which are designated "controlled merchandise" though not manufactured by them. Such merchandise is produced exclusively for one company according to its specifications and directions. Goods so controlled require a more intricate processing than the chain is willing to undertake, or are sold in such small quantities that their manufacture by the chain is not warranted. Goods of this character are controlled by the chain through its:

1. Design or invention of the product or container.
2. Ownership of patents, dies, molds, or formulas necessary for the production of a given product.
3. Ownership of the brand applied to the product.
4. Restriction of sales of the product to its own stores or agents.²¹

The simplicity of processing is one of the determining factors when a decision must be made by the chain as to what products to manufacture. Such commodities as cold creams, toothpastes, shaving creams, lotions, cleaning fluids, powder, and rouge naturally receive favorable consideration because their process-

²¹ The Owl Drug Company, e.g., has its own complete controlled lines of brushes, rubber goods, fountain pens, pencils, and other goods manufactured under contract by other companies. The Owl Drug Company owns the brands, molds, and formulas.

ing is merely one of blending certain ingredients. Such merchandise as epsom salts, cod-liver oil, olive oil, bay rum, boric acid, and the like are also handled because these items can be bought in bulk and require only packaging or bottling and branding to give the chain its own product. These latter products are favorites among drug chains when they consider products for private branding.

A second consideration is the demand for a product. Unless the chains can create a fairly large demand for a privately branded article, there is no object in manufacturing it. It is impossible, or at least very difficult, to say exactly what sales volume a product must have before it can be profitably manufactured by a chain. This will be possible, it may be assumed, only when the volume is large enough to assure economical purchase of raw material and permit full-time operation of equipment. This latter difficulty may be overcome to some extent by the proper planning of the work so that a different commodity may be produced on alternate days with the same machinery. Another method is to adopt the plan utilized by the Owl and the United drug companies, which have established agencies, thereby increasing the sale of the goods they produce.

The following example is cited to show how, presumably, chains decide what products to manufacture and how demand for them is created.

The only items which can be made in a Walgreen factory are those which meet a demand created by the advertising of other manufacturers. For example, the manufacturers of cold cream have established a demand for this product. The public has been educated by advertising to consider the 50-cent size the standard; consequently demand is greater for cold cream at this price than for the 25-cent or the \$1.00 size. In order to sell a large volume the Walgreen Company prepares a cream of good quality and sells it at 43 cents, a price which convinces the

public that the item is in the 50-cent class. Thus customers consider that they are being offered a bargain.²²

The Walgreen Company attempts to manufacture in its factory those products which have become standardized as to both demand and price. Then by a reduction in the price of their own goods below the standard price of competitive goods, the company attempts to create a demand for its products in direct competition with suppliers' products, and often attains a volume just less than that of the leading national brands. It has been found that pushing the sale of the nationally advertised product greatly aids the sale of the Walgreen product. This fact is considered when the sales price for the private brand is fixed, for if there is too great a difference between the price of the privately branded article and that of the commodity with which it is to compete, the public fails to make the comparison in values, with the result that the sale of the privately branded merchandise suffers.

Chains do not advertise their own brands extensively except in their windows and in store displays, because the volume attained does not usually justify great expenditure, though extensive advertising would undoubtedly increase volume somewhat. Such advertising necessarily has to compete with the extensive national and local advertising of competitors, having much wider distribution. The larger chain is more favorably situated than the smaller in this respect.

Usually the products manufactured by the chains are not sold to other concerns. An exception to this policy is found where the chain has established non-competing agencies such as those of the Owl Drug Company and the United Drug Company. This restriction of outlets enables the chain to control the price and to establish a repeat business for the companies' own stores.

²² Lohr, *op. cit.*, pp. 40-49, 70-72.

EXTENT AND POSSIBILITIES OF CHAIN MANUFACTURING

Although most drug chains have found it desirable to manufacture (or control) some of the products which they sell, the ratio of the sales of such products to total sales is still rather small. The Buck & Rayner Company estimated (1927) that the volume of its own goods was not more than 5 per cent of its total sales. The Owl Drug Company (1928) estimated this percentage to be 20 per cent; the Walgreen Company, 5 per cent; the Liggett Company (United Drug Products), 16-17 per cent. The Liggett Company has made strenuous efforts to increase this percentage. Since the organization of Drug Incorporated and its acquisition of companies manufacturing other drug products, the percentage of own goods sales to total sales has, no doubt, increased. Five per cent of the total sales of the Peoples Drug Company is reported to consist of its own goods.

W. H. Mullen reported in 1924 that manufacturing by drug chains was narrower in scope than in the case of some grocery chains. It was usually limited to medicines, drugs and chemicals, and toilet articles. The lack of sales concentration made it unprofitable for even the largest chains to produce a wide range of commodities. But these three lines produced probably 50 per cent of total sales of chain drug stores, so that it was possible for the chains to produce several of the leading items in these three classes.²³

In 1931 M. M. Zimmerman stated:

Chains do not carry on manufacturing operations on so great a scale as many of us have been led to believe. We cannot see that in the food, drug, tobacco, hardware, or similar fields the time will ever come when manufactures in any large number will be forced to enter the retail trade. It is almost impossible for even a group of manufacturers to become retailers if they think of their products in terms of national distribution. . . .²⁴

²³ *Op. cit.*, pp. 69 ff.

²⁴ *Printers' Ink* (February 26, 1931) as quoted in *The Facts in Food Distribution*, IV, No. 2 (March 7, 1931), 10. See also Federal Trade Commission report, *op. cit.*

It is impossible to predict with accuracy how far the drug chains will attempt to go in their efforts to produce the commodities which they sell, but it is certain that they have not reached the limit of their expansion in this direction. The Chicago purchasing agent of the Owl Drug Company frankly admits that his company intends to produce more and more products as long as profits warrant. He states that manufacturers who aid in the growth and development of a drug chain are likely to be creating additional competition for themselves. Expansion along this line is a natural development, according to this purchasing agent, because a company controlling a large number of outlets is sure to seek control of the products being sold in them whenever it is to their financial interest to do so.

This same buyer maintains that it is much easier for the chain to engage in manufacturing activities than for the manufacturer to engage in retail activities because:

1. The problem of manufacturing is simple when compared with that of retailing.

2. The chains have the most desirable locations and it has become exceedingly difficult for a manufacturer to secure desirable sites.

3. It takes a large amount of capital to develop a chain of retail stores in a wide area and the manufacturer setting out to develop his own outlets will be handicapped, whereas capital requirements for the manufacture of many drug-store products are small.

4. A manufacturer who attempts to enter the retail market himself would stir up much opposition and would be likely to lose a good part of his present market. On the other hand, the manufacturer is helpless to combat the manufacturing activities of the chain.

There are certain difficulties connected with the merchandising of their own goods with which the chains must contend:

1. These goods must be displayed to be sold, yet a window of "own goods" merchandise does not attract as many customers into the store as a display of nationally known goods.

2. They require much more time and sales effort on the part of clerks, because they are not well known, whereas the nationally known items require little more than a suggestion if the prospective customer is in the market for the article.

3. They often prove embarrassing to the chain when an agreement with manufacturers of competing products is being considered, and sometimes stand in the way of complete co-operation. The manufacturer naturally resents the chain's manufacturing activities and is well aware that they prevent him from securing the full sales co-operation of the chains.

It is doubtful whether the drug chains will ever be able to manufacture a large percentage of the products which they sell because, first, the demand created by manufacturers for their products cannot be successfully resisted in the stores, and, second, a great variety of novelties and sundries must be constantly secured and no one company is likely to find it possible to create these new products.²⁵

CO-OPERATIVE BUYING

Today no discussion of purchasing is complete unless it contains some reference to co-operative buying, a subject that becomes of increasing importance each year. The co-operative buying movement is a rather recent development, coming very largely after the period when chain stores first came into prominence. It is generally conceded that the movement has been due in large part to an effort made by independents to secure the same buying advantages which the chain stores enjoy. It has usually been assumed that the size of the order is

²⁵ The methods which may be used by a drug chain in promoting its own goods are indicated by the case of *Vapex v. Vapure* ("Substitution To Have Its Day in Court," *Advertising and Selling*, XV, No. 11 [October 1, 1930], 36). The case also indicates a fundamental purchasing practice.

the one thing in which the manufacturer is interested, and that an equal discount should be allowed on orders of equal size. There are two fallacies in this assumption, both of which are a part of the reason why co-operative buying associations are not as successful as those who participate in them generally assume that they will be.

First, a continually increasing volume does not mean a continually decreasing cost. Costs decline only up to a certain point, beyond which they either remain stationary or increase. The mere increase, therefore, in the size of an order does not always justify a lower price, though many manufacturers do not realize this fact. It is true that this applies just as effectively to chain orders as to co-operatives, but here a second factor enters. The chain is enabled to promise and deliver much closer sales co-operation and more effective selling in all its stores than the co-operative, which has typically little central control over its member stores. The mere placing of a large order by a large group of stores does not mean that more of the company's product is being sold in those stores than when their small orders were received by the manufacturer separately. It is true that the cost of handling one large order is usually less than that of many small ones, but this is not the only concern of the manufacturer. He is interested in the total volume of his products sold in a given period, and not only in the size of a single order. With the chain he is likely to secure, store for store, a much greater volume than he will, store for store, from the co-operative group of independents. He, therefore, feels justified in giving the chain a price advantage.

Though the co-operative buying movement is generally thought of in connection with independents, the chain stores themselves are in an even better position to do co-operative buying than the independents are. The large drug chains, however, have found that they have little to gain from co-operative buying, though many of them belong to co-operative buying

associations. The smaller drug-chain organizations have apparently found some advantages in this form of buying not to be obtained in any other way. Most of the smaller drug companies belong to such groups, and it is largely with these that the present discussion is concerned.

Probably the best-known and largest co-operative organization of drug chains is that called the Associated Chain Drug Stores, which maintains a buying office in New York City. In 1927 the membership of this organization represented thirty companies having five hundred stores, with sales of approximately \$100,000,000 yearly. In 1930 the association had twenty-two members with twelve hundred stores.²⁶ This association owns the H. S. Benedict Company, Inc., of New York, and in addition to its jobbing functions produces a number of articles under its own name which are sold both in members' stores and to outsiders. The association has for its purpose, in addition, the "exchange of experiences, plans, methods, etc., and to afford full interchange of information and opinions on all subjects."²⁷ The organization represents much greater buying power today because of the great growth of the chains in the organization. It is not to be understood that any great percentage of the merchandise sold by these chains is purchased co-operatively, for this is not the case, especially as regards the larger organizations. The co-operative usually confines its activities to those lines in which the individual chain's volume is not large enough to allow it to get quantity discounts itself. Sometimes the pooled purchasing power will allow the syndicate to take the output of an entire factory. The syndicate mentioned above, for example, takes the entire output of a rubber products factory.

The Affiliated Drug Stores is another co-operative drug-

²⁶ *Chain Store Age*, VIII, No. 2 (druggists' ed.; drug. prod. sec.; February, 1931), 12.

²⁷ From a letter of D. C. Keller, president of the association (August 5, 1927).

chain organization having some thirty members with five hundred stores. Its members are smaller organizations, and it may be assumed that they buy a much greater percentage of their total volume through the co-operative than those belonging to the Associated Chain Drug Stores.²⁸

The majority of the products purchased co-operatively by the chains are standard merchandise not subject to such capricious demand as that of novelty and less standardized goods. Aside from their own privately branded goods, the chain drug companies differ most widely in that class of goods which they designate as "sundries" or "novelties." Each chain attempts to secure some advantage over its competitors with respect to this class of commodities, and, except under special circumstances, such merchandise is not bought co-operatively.

The situation is somewhat different with independent co-operatives. Here the tendency is for the co-operative buying office to discover novelties and sundry items for sale and to urge the independent merchants, who have little chance to scout for such merchandise, to handle them. Typically this class of merchandise is very profitable but must be selected with care as to kind and quantity; otherwise profits of many sales are dissipated on one poor buy or on the carrying of surplus stock. The co-operative buying office (or the buyers acting for co-operating groups of merchants) is in a much better position to make the selections than are the individual merchants for whom it acts.

The co-operative buying activities of the drug chains are not important in comparison with the drug-chain volume done. For the most part, the organization formed to carry on the work of the syndicate is small, consisting of a manager with, perhaps, an assistant or two. The manager acts as the purchasing agent and buys only on specific instructions from mem-

²⁸ *Chain Store Age*, VII, No. 2 (druggists' ed.; drug prod. sec.; February, 1931), 16.

bers. Only when members agree to purchase certain goods in co-operation by taking, for example, the complete output of a factory, are they bound to purchase anything through the syndicate. In other words, members place their orders much as they would with a jobber to whom they specify the price. Little leeway is allowed the syndicate manager as regards the quality and price of goods which he buys for members. Because the syndicate usually does not operate a warehouse, goods must be shipped directly to the individual chain's warehouses. Each chain usually owns an equal number of shares of stock and has an equal vote in the management. The syndicate may charge a fixed percentage above the purchase price, which goes to pay the expenses of operation and the manager's salary. Usually syndicates are not operated for profit. The majority of chain-drug-company buying officials are not very enthusiastic over co-operative buying and prefer to do their own buying whenever possible.

CHAPTER IV

BUYING ADVANTAGES

DOES THE CHAIN POSSESS GREAT BUYING ADVANTAGES OVER ITS INDEPENDENT COMPETITOR?

This is a moot question and is likely to remain so until many facts not now known are secured. It is generally admitted that chain stores have had and still do possess some price advantage in buying. The controversy usually hinges around the extent and importance of this advantage, whether it will continue and whether it is fair. Almost every marketing book written that contains reference to the subject expresses the author's opinion that one of the chain's chief advantages is the lower price for which it buys because of the large volume in which it orders. It has already been pointed out that the mere size of an order is not all that is important to a manufacturer, there being a limit to decreasing costs resulting from large orders.¹

Some manufacturers frankly admit that they give chains preferential treatment. In the following quotation one manufacturer indicates his reasons.

When our representative calls on one of the leading chain or mail-order buyers he is welcomed as one business man welcomes another. They go right to work. Instead of showing our samples to a buyer whose stock remark is, "Your price is too high—you've got to do better," we sit down with a buyer who says: "Show me your samples."

And usually we find a man who not only knows the product but knows how it is made or should be made. He is alive to the latest methods and he can figure costs with us practically as well as we can ourselves.

For instance, one of these buyers asked me recently how we secured a certain finish on one of our products. We told him our process and the name of the machine we used.

¹ Cf. P. H. Nystrom, *Chain Stores* (rev. ed.; April, 1930), pp. 15 ff.

You're spending 3 cents apiece as you say, when you use that method, but you ought to buy a Blank machine. It will cost you \$8,500 but you'll cut that operation cost to less than a cent and you'll do a more uniform job.

The buyer was right. We knew the equipment he had in mind. We had been considering it and we replied:

Our present runs are not large enough to warrant that investment but if you are interested and will give us quantities aggregating to a half million units at a time, it will pay us to buy that equipment.

We were talking with a buyer who talked our shop language. Within an hour we arrived at the following: we were to submit our cost figures, based on minimum runs of a half million units per order. Details as to quality and finish were to accompany these costs. We were to mark up 10 per cent on the cost price for selling and administrative expense and 10 per cent for net profit. If our methods were incorrect, this buyer had an expert on his pay roll who would come and help us get properly organized. Also he would help see that we made the net profit to which the buyer knew we were entitled.²

The author ends by asking the question, Is it any wonder the manufacturer sells to the chain for less than he does the jobber?

The following quotation expresses a different point of view with respect to the prices secured by the chains:

Chain stores do sometimes secure secret or camouflaged price concessions, but they secure them by devious methods instead of effecting some economic saving. Consequently, their efforts sooner or later meet with resistance from those who have been despoiled of legitimate profits. . . .³

Mr. T. K. Kelly, a bitter antagonist of the chain system, has commented thus on the buying advantages imputed to chains:

There is positively no reason why the buying power so-called of chain organizations can deliver to them a marked superiority over the independent retailer.

The independent retailer has at his command the process of coöpera-

² A. D. Dente, "Do Jobbers Deserve the Same Price as Chains and Mail-Order Houses?" *Printers' Ink*, CLIV, No. 7 (February 12, 1931), 2 ff. The quotation is taken from p. 4.

³ "The Chain Store Is Not Economical," *Retail Grocers' Advocate*, No. 2439 (February 5, 1927), p. 3.

tive buying through which he can match up very adequately with the buying power of the chain store. . . .⁴

P. H. Nystrom, on the other hand, may be quoted as follows:

When we come to buying, however, the chain stores enjoy an undoubted advantage over most independent stores because of their power to buy in large quantities.

Buying advantages are almost certain to be equalized between chain and independent retailers through the gradual development of associated efforts of the independent retailers themselves.⁵

Dr. Nystrom is perhaps as impartial an authority as can be found. He believes that, although chain stores do have a buying advantage because of the volume of their purchases, this advantage is somewhat offset by warehouse operating costs. Moreover, the independents themselves will co-operate in buying to such an extent as to wipe out even the slight advantages which he believes the chains now have.

Mr. G. M. Lebhar, a chain-store partisan, presents what he believes to be statistical evidence that grocery chains (and he implies that the same general conclusions carry over into other chain fields) purchase their goods at 13 per cent less than the independent retailers. He says:

Just how much of a buying advantage the chains have over the average independent grocer may be gathered from the fact that, according to the Harvard Bureau of Business Research, the gross margin of the whole-sale grocer, from whom the retailer must obtain his goods, amounts to 11.3 per cent of his sales. In other words, the chain store, which buys on the same terms as the jobber, pays only 88.7 cents for merchandise which costs the independent grocer \$1.00. The independent pays 13 per cent

⁴ T. K. Kelly in a debate between T. K. Kelly and G. M. Lebhar, "*Resolved: That the Chain Store Method of Distribution Is Not to the Public Interest,*" "Chain Store Wins in Debate before Illinois Clothiers," *Daily News Record*, February 10, 1928, pp. 1 ff. The quotation is from p. 8. The fallacies in reasoning and the resort to prejudice are so common in this speech that the value of a quotation from it is doubtful. See also *Is the Chain Store a Menace?* (Chicago: Carson Pirie Scott & Co.).

⁵ *Op. cit.*, pp. 15 and 21.

more for merchandise than the chain. . . . The Harvard Bureau tells us that the typical independent grocer's operating expenses amount to 17.3 per cent of his sales, whereas, according to Dr. Nystrom, in an investigation he made for the United States Chamber of Commerce, the chain's operating expenses average only 15 per cent. And the chain's 15 per cent covers the cost of operating not only the unit stores but the headquarters and warehouses as well!⁶

Mr. Lebhar has made a strong point in his effort to show that chains do buy more cheaply than independents. He has not, however, touched upon the question of "inside" prices or discounts allowed beyond those given to the jobber. The very secrecy with which the chains attempt to protect this price information seems to justify further suspicion as to the nature and amount of these discounts. The following points are submitted as evidence that chain drug companies are securing secret discounts from manufacturers.⁷

1. One chain drug company has a "discounts ledger" in which all confidential discounts given the company are recorded. Only the auditor or his assistant is ever allowed to work on this ledger. The information is considered too highly confidential to be intrusted to the ordinary employee.

2. An official of another chain displayed a purchase contract signed by him and the manufacturer's salesman which both the official and the salesman declared called for a lower purchase price for the article in question than any other company could secure.

3. In a recent merger, the drug chain purchased was compelled by agreement with manufacturers to destroy its pur-

⁶ "Chain Store Wins in Debate before Illinois Clothiers," *op. cit.*, p. 9. Mr. Lebhar fails to point out that the operating costs of the chains are little less (according to Dr. Nystrom) than those of their independent competitors after adding the average wholesalers' costs to the latter and after taking into consideration the type of service rendered by both.

⁷ It must be admitted that some of the evidence is only evidence by inference, but I consider it significant. Much of this information had to be secured indirectly and surreptitiously.

chase agreements to keep them from falling into the hands of the purchasing company, because the manufacturers had made certain price concessions to the former concern that they were not prepared to make to the latter.

4. Inspection of the purchase control cards of two chain drug companies disclosed the fact that one manufacturer allowed them discounts of far greater amounts and datings of bills much more favorable than it ordinarily allowed wholesalers. It may be, of course, that wholesalers were also being given secret consideration by this manufacturer.

5. The purchasing agents of two large drug companies assert that they get better discounts than jobbers or independents on certain items. The same officials also claim that on certain commodities they get better discounts than their chain competitors.

6. Chain stores often quote prices for articles which are below the independent retailer's, and sometimes below the jobber's purchase price, which they claim to be selling at cost or at a very small margin of profit. During a recent Kolynos toothpaste campaign, for example, a Chicago drug chain was selling a combination of three items for very little more than it cost the independent retailer to buy the toothpaste alone. The chain, according to its head buyer, was making a satisfactory profit on each sale.

In a survey conducted by the Association of National Advertisers, 32 out of 34 manufacturers answered "no" to the question, "Do you sell these buyers [syndicates, chain, and mail order] on a different basis than [*sic*] your usual distributor or retailer?" To another question, "Do you treat the big buyers differently than [*sic*] you do the smaller or sectional organizations?", 27 out of 33 stated that they did not differentiate, while 6 said that they did. In summarizing, the report states:

Taking it all in all, however, it would appear that the average manufacturer is willing to treat the chain or syndicate on the same basis as the

wholesaler, when he orders in similar quantities, and performs the regular wholesale functions.⁸

Ten of the leading drug manufacturers were sent questionnaires requesting information concerning their price policies as they apply to chain stores, independent stores, and jobbers. Five replies were received, and in each case the manufacturer claims to have established a uniform price policy which applies alike to all customers, usually with a provision for some kind of a graduated quantity discount.

Despite the general disclaimer of manufacturers with regard to the granting of special discounts to certain drug chains, such statements do not all appear to be sincere, and it can be readily understood why manufacturers should wish to keep their terms secret. No matter how justifiable the practice might be, the manufacturer would be sure to create trouble for himself, as has sometimes been the case when he accorded the chain the right to buy directly.⁹ Discounts are given in many ways other than in cash and thus are more easily concealed. The justification for this practice will be discussed shortly.¹⁰

There are really two questions involved in the matter of discounts: (1) Should the chain be accorded the same discount terms as the jobber? (2) Is the manufacturer justified in giving or is the practice ethical for chains to ask and get so-called secret discounts or discounts below those allowed competitors?

These questions are difficult to answer. The chain will, of course, see one side of the question and wholesalers and independents the other, while the manufacturer is likely to be

⁸ *Selling Syndicates, Chain Stores, and Mail-Order Houses*, a pamphlet lent to the author in 1928.

⁹ One of the largest drug wholesalers in Chicago has adopted the policy of passive resistance toward all goods made by manufacturers who are too friendly with chain stores. Whenever possible, the officials substitute other brands of merchandise for those made by these manufacturers.

¹⁰ The question of buying from brokers has not been discussed, principally because adequate information has not been secured. Chains do buy from brokers, though not as a regular procedure. They use the latter when making special deals, as in the purchase of distress merchandise, more than at any other time.

guided by the policy which he believes will yield him the greatest volume of business, though he sometimes forgets that mere volume will not create profits.

It seems only reasonable that chains with a volume that will enable them to buy directly in quantities comparable with those of wholesalers should be accorded at least the same price concessions. The wholesaler has no monopoly on his position in the marketing structure. If there are those who can dispense with his services without additional cost to the manufacturer, there seems to be no economic reason, though there may be reasons of expediency, why the manufacturer should hinder such a development. These reasons may be advanced for equality of treatment:

1. With comparable volume the expense incurred in selling to a chain is no more than that which is necessary in selling to a wholesaler and over a period of time the average cost is probably less.

2. The expense in selling repeat orders to the chain is very small, for if a product is satisfactory the chain will continue to handle it. The chain may, of course, bring pressure to bear on the manufacturer for additional concessions, but those are not legitimate selling expenses, though indirectly they may be considered as such. The expense of continuous selling to wholesalers is likely to be greater.

3. The average chain is usually a better credit risk than the average drug wholesaler.

4. The chain co-operates with the manufacturer by placing orders for production during slack seasons, thus reducing the cost of operations by keeping the plant in continuous activity. The chain can do this because it knows more nearly what its sales are going to be than does the wholesaler who has yet to solicit orders.

5. The chain performs all the functions of the wholesaler as well as those of the retailer.

6. The chain gives the product widespread distribution and develops a prestige and market for the product that cannot be secured as quickly or as cheaply in any other way. This is a claim which the chain makes, and though there is a tendency to overestimate its value, the very fact that so many manufacturers attempt to secure introductions of commodities through chain drug stores is evidence pointing to its value as a method.

7. The size of the chain's order is such as to justify discounts as large as, or larger than, those accorded many wholesalers.

There is little point in arguing that the independent retailer as an individual should be put on a parity with the chain store in the matter of price, because the expense of handling many small orders directly would not permit the manufacturer to do this. The only possible way in which the independent retailer may benefit from the price policy of the manufacturer is through the treatment accorded the wholesaler.

The points given above seem clearly to justify the chain in getting, and the manufacturer in giving, the same terms of sale as those given to wholesalers and jobbers. It is not so easy to justify any extra or secret discounts, which, it has already been said, many manufacturers allow the chains, especially the larger ones. The charge and the citing of proof that such information is kept secret is not saying that the chains are not justified in asking and getting additional discounts if they can, or that the manufacturers are not justified in giving them.

Since the matter is veiled in so much secrecy, the extent of the practice and the amount of the discount can scarcely be estimated. If the chain is less costly to sell to than the jobber, gives more satisfactory and complete distribution in its territory, creates a prestige and consumer acceptance for the product that cannot be obtained from the jobber, and if the chain really co-operates with the manufacturer so that his plant is

busy when it might otherwise be idle—if these claims, made by both manufacturer and chain, are founded on fact, it would appear that there is considerable justification for granting additional favors to the chain as against the jobber, for the chain performs all the functions of the jobber and renders other services besides. But the practice of giving these rebates secretly or in such a manner as to obscure their real nature seems highly unethical, for it leaves competitors of the chain helpless to conform, in order that they too may become the beneficiaries of the plan. In fact, the practice appears very much like that employed by the railroads and the Standard Oil Company, which was condemned and forbidden by the courts, and which stands today in the minds of most people as having been a most unethical, not to say immoral, practice. If the manufacturer feels justified in according extra favors to the chain, these favors should be accorded openly and explained and defended, if need be.

It seems plausible to assume that the buying advantage possessed by chain stores as against the independent merchant is greatly overrated, especially when considered as the chief or prime element in their success. There is no intention of belittling the importance of the cost of merchandise purchased in the drug business, for the price competition among drug stores of all kinds is exceedingly keen, and the ability to offer low prices depends to some extent upon the power to buy at a low price. Even so, many other factors weigh heavily in the success of the drug store, and it seems that many of these have been largely overlooked because of overemphasis upon buying advantages. The co-operative movement has placed one weapon in the hands of the independent by which he can overcome a great deal of the price advantage accorded the chain because of the size of its purchase orders. There are also many other evidences that point to the fact that buying is not an all-important advantage. There are many independent drug

stores known to the writer to be as successful as any chain drug store, many of them located in cities such as Chicago where competition is keenest.¹¹

It might also be pointed out that the small drug chains are often the best profit-makers, and yet as far as buying is concerned they are at about the same disadvantage when compared with the large chains as the independents. Thus, the Buck & Rayner Drug Company of Chicago and the Peoples Drug Company of Washington may be cited as two small drug chains that have prospered.

Again, mere buying advantage does not insure success. There are several drug chains (such as the Economical Drug Company of Chicago and the Neve Drug Company of New York) that have failed because they lacked other essentials, even though they purchased in relatively large quantities. A chain would suffer less through the sacrifice of any buying advantage it might have than it would through the loss of its skilled sales and personnel management. A case illustrating this statement is that of the English chain, Boots the Chemists, controlled by the United Drug Company. This chain of over eight hundred stores prospers despite the fact that price maintenance is allowed in England, making it possible for the smallest dealers to sell nearly all the well-known trade-marked articles at the same price. Though this does not prevent the company from getting price concessions in buying, it does show that as far as these concessions can be used as a competitive sales weapon, they are of little or no effect. Boots is compelled to secure its customers by other means.¹²

¹¹ E.g., in 1928 the Katz Drug Company of Kansas City did \$5,771,362 of business in only two drug stores. See *Chain Store Age*, II, No. 5 (druggists' ed.; February, 1929). Also Eugene Whitmore, "Dartnell Check-Up of Chain Store Competition Continues," *Sales Management*, XI, No. 4 (August 21, 1926), 266.

¹² Jack Brooks, "When Price Appeal Doesn't Figure," *Chain Store Age*, III, No. 4 (April, 1927), p. 29.

DISCOUNTS SECURED BY THE CHAINS

Discounts and special concessions to the drug trade by manufacturers take many forms, among them the following:

1. *Cash discounts*.—This is the most universal of all discounts and probably the most uniform. It is usually 2 per cent, but the period for which it is allowed varies somewhat, ranging from ten to twenty days, though the former is the more common period.¹³ It is an invariable rule with drug chains to take all cash discounts, and finances are maintained so that this can be done.

2. *Wholesale trade discounts*.—Trade discounts are also common, being allowed to those engaged in the wholesale or jobbing trade by the manufacturers. It has already been pointed out that chain stores, and independents also, who buy in job lots are usually allowed the trade discount, to which practice most wholesalers object. In the drug trade the most common trade discount seems to be 15 per cent from list price, though the range is very great, in many cases extending to 50 and 60 per cent of list, with 20 and 30 per cent being quite common percentages.¹⁴ The trade discount is allowed the chains because they perform the functions of the wholesaler.

3. *Quantity discount*.—Most manufacturers now make some provision for granting quantity discounts. In fact, in order to get away from charges of unfairness in the granting of trade discounts, many manufacturers have substituted quantity discounts entirely, which they allow to all who buy the specified quantity. In the drug trade the rates usually are graduated according to quantities taken so that the larger buyers receive the larger discounts. Again, the discount is sometimes used as

¹³ One per cent is also a very common percentage for the cash discount in the drug trade. See also discussion in P. D. Converse, *Marketing Methods and Policies*, p. 482.

¹⁴ Converse (*ibid.*, pp. 483–85) has a discussion as to the nature of the trade discount and reasons for and against it.

a means of getting the buyer to take the manufacturer's complete line and will not be given unless this is done. For the most part, drug chains refuse to consent to this scheme unless all the products in the line sell reasonably well, for the disadvantage of "dead" stock more than offsets the discounts to be secured in this way. The maximum quantity discount—and this is one most commonly secured by the four drug chains studied—is 5 per cent, though they range from 1 to 5 per cent and in a few cases are even more.¹⁵

The quantity that must be taken to secure discounts of varying amounts differs with each type of product, depending upon the nature of the commodity and its demand. Information with regard to the discounts on specific products is almost impossible to secure (or if secured may not be used). The chains, it is safe to say, almost always order in quantities far larger than those purchased by the ordinary druggist, very often buying the standard commodities in lots of twelve gross, for which amount the maximum quantity discount is usually allowed. Carload lots of certain commodities are not uncommon, as, for example, Kotex, cigarettes (popular brands), Listerine, and a few other popular sellers. On such large orders the chains often receive quantity discounts of far more than 5 per cent.

4. *Advertising allowances.*¹⁶—This type of discount has come to be very common with the manufacturer. All of the large chain drug companies get much of this kind of help from manufacturers. The usual form is for the chain to take space, normally a full page, in the newspapers in those cities where it operates a number of stores and to combine certain of its own

¹⁵ *Ibid.*, p. 481.

¹⁶ See Appen. II. See also F. S. Clark, "The Drug Trade, Too, Has Its Advertising Rackets," *Sales Management*, XXV, No. 3 (January 17, 1931), 100; Don Gridley, "Coöperative Dealer Advertising or Dealer Subsidies?" *Printers' Ink*, CLIV, No. 8 (February 19, 1931), 49 ff.; L. S. Lyon, *Advertising Allowances* (Washington, D.C.: Brookings Institution, 1932).

advertising with that paid for by the manufacturers. This advertising allowance is a very real discount on the cost of the goods because the cost of selling them is greatly reduced for the chain. These allowances may run into thousands of dollars yearly for one manufacturer and mount very rapidly when the number giving such aid is considered.

5. *Rebates*.—The rebate, though of great advantage to the chain, is not peculiar to it. It is offered by manufacturers as an aid in stimulating sales effort on the part of those handling their products. The rebate is a powerful stimulus to the sales efforts of chains, and because the quantities fixed are usually unattainable by any but those handling the goods in wholesale lots, the independent drug store has little possibility of getting this form of discount. This is a real source of profit for the drug chain and is secured on the basis of total volume done in a specified period, usually one year. Although the chains would not disclose the usual amount of the rebate secured, it is thought to be about the same percentage as the quantity discount for which it is sometimes substituted. It is offered on a sliding scale of percentages according to volume done.

6. *Clerk's commissions*.—This form of discount is one greatly favored by the chains and is being urged on the manufacturer more and more. It seems one of the most objectionable forms of discount because of its secrecy, since it gives one manufacturer an unwarranted claim on the time and effort of clerks as against other manufacturers who may be co-operating in other ways, and it often places the public in the hands of hidden demonstrators—a practice which is generally condemned by retailers as being unfair to the public. The usual method is for the manufacturer to give the chain a certain cash sum for use in stimulating clerks to sell this manufacturer's product. Sometimes the manufacturer specifies how this shall be used, while at other times no such specification is made. Rebates are often given to clerks as prize money for sales contests on the manu-

facturer's items: at other times a commission is paid on all the sales of this item. In almost all cases, clerks are informed that the manufacturer is responsible for the awards, and they are urged to co-operate to the fullest extent in the sale of his products.

Other manufacturers, instead of paying commissions, either maintain clerks in some of the more important stores of the company or furnish free of cost the chain demonstrators who help to sell the products of the manufacturers.

7. *Window rentals*.—The practice of renting windows to the manufacturers came about when the chain stores discovered how valuable their window space was and how anxious manufacturers were to use it. Some suppliers have been willing to pay large sums just to get their products in the windows of the chain units for the advertising value of the display as well as for the immediate sales resulting therefrom. The Liggett Drug Company formerly sold its window space outright to manufacturers, and revenue in one year reached approximately \$600,000, but the company discontinued this practice because it found it had no space for the display of its own goods. Now, as with most drug chains, the window display is used as a bait for manufacturers and as a club to secure the ultimate in low purchase price, so that as far as the results are concerned, it matters little which way the window space is handled. The Walgreen Company still sells window space outright, but favors those manufacturers who make the best price concessions.

8. *Free deals*.—Free deals are used by manufacturers to encourage large orders. With orders of certain sizes, the manufacturer agrees to contribute an additional amount of merchandise. In other words, the manufacturer gives the discount in goods rather than cash, and thus thinks he is increasing his total merchandise sales and securing dealer co-operation. Free deals are usually open to all, though generally the chain, be-

cause of its larger purchase orders, gets a better deal than its competitors. The free deal, while acting as a benefit to the chain, the buyers for which do not accept it unless they are sure that the chain can use the merchandise, has often led the unwary independent into trouble, because he has purchased simply to take advantage of what he thought was a good proposition, and then found himself overstocked with unsalable merchandise.¹⁷

9. *Samples*.—Manufacturers often supply chains with great quantities of samples, usually at the request of chains who may refuse to buy and feature the manufacturers' products unless this request is granted. These samples are then generally used by the chain to encourage sales, by giving them as gifts to the consumer who buys a specified amount of merchandise. For example, the Buck & Rayner Company conducted annually a birthday sale at which time it gave gift bags containing samples with every \$1.00 purchase. Thousands of samples were furnished by manufacturers for this purpose. Nearly all drug chains use this or similar methods at various times. It is said to be highly valued by manufacturers as a method of advertising.

10. *Dating bills ahead*.—Great controversy has raged around the question of whether or not manufacturers actually date bills ahead, which is, in effect, another method of giving the chain a cash discount. There is no doubt that this is done in many instances, since the drug chains' buyers themselves admit it and cite it as a way in which the manufacturer may cooperate.

11. *Paying freight*.—Many manufacturers quote to the chain terms according to which, on orders of a certain size or over, they will pay the freight. This is often a very important concession, especially if the chain's warehouse is far from the

¹⁷ Cf. H. R. Mayes, "How Free Are Free Deals?" *American Druggist*, LXXVI, No. 5 (November, 1927), 20 ff.

manufacturer's factory. Usually the size of the order is such that only the large buyers can secure this concession.¹⁸

12. *Guaranteed profits*.—Another practice which has recently come to light is one introduced by a candy manufacturer who placed his stock in a certain chain store, guaranteed a certain percentage of profits, and agreed to take back all stock not sold after the period of the holidays. This appears to be commission selling, yet is a special concession to this chain because it is not available to the majority of independents. The extent of this practice is not known, though commission selling is rather common.

The foregoing are the most usual methods by which concessions are made to the chain drug companies by manufacturers. It is not to be presumed that all of them are confined exclusively to the chain organizations, or that all chain organizations are treated alike. But in many instances, if not in the majority, the chain is favored above most of its competitors. This may be entirely justified, because the chain is generally a larger-volume buyer and most concessions are established on a volume basis. In several cases, such as advertising allowances, commissions to clerks, and window rentals, it is almost certain that the manufacturers accord the chain privileges that they seldom give to competitors.

In addition to these methods of making concessions to the drug chains, the manufacturers also aid them in many ways less direct. These additional buying concessions may take many forms, such as furnishing demonstrators and specialty salesmen, making split shipments, packing according to chain specifications, giving liberal return allowances for damaged goods, making commission sales, manufacturing to order, giv-

¹⁸ The full significance of freight charges on the cost of merchandise sold is seldom realized. Lack of space prevents further discussion here, but interested readers are referred to the author's thesis, *Organization, Management and Control of Chain Drug Stores*, chap. viii.

ing the chain a time preference over competitors in the sale of an article, granting protection against price changes, supplying window-trimming material, allowing cancellation privileges on orders, and the like.

In splitting shipments the manufacturer must ship a part of the goods ordered to the individual units of the chain. This is expensive for the manufacturer but relieves the chain of the cost of receiving, packing, and reshipping. Drug chains have struggled with many manufacturers to get them to pack according to specifications, such as putting the chain order number on all packages and packing in the size convenient for the chain's use. An example of the latter is packing a number of all kinds of fountain dishes in one barrel rather than all cups in one and saucers in another. Naturally this is a great convenience to the chain but is an added expense to the manufacturer. In the matter of return allowances, the chain typically makes arrangements whereby many suppliers settle for damaged, spoiled, and other non-salable goods at periodic intervals, on terms favorable to the chain.

On commission sales the goods are not paid for until sold, and if not sold are returned to the supplier. The latter thus bears most of the risks, and the chain has less of its own capital tied up in store stocks. This is a very effective way of getting new goods introduced with very little risk to the chain, and the practice has grown rapidly. Some chain purchasing agents frown on the practice, because they do not believe the policy sound except in unusual circumstances. They hold that if the buyer is not convinced that the product will sell in company stores, it should not be allowed to occupy valuable display space, occupy the sales efforts of clerks which are already scattered, and make necessary special accounting. Two of the largest drug chains, however, nearly always refuse to take new merchandise except on consignment, or, what virtually amounts to that, with the right to return any unsold portion

within a time limit, after which they do not want the product if the initial amount ordered has not been sold, for it indicates a slow-moving item. The following quotation illustrates this growing practice in the drug trade:

Department stores are now asking toilet goods manufacturers to consign their products to them. No pay until sold.

Each manufacturer is asked to see that an adequate stock of his merchandise is kept in the warehouse of the department store subject to requisition as needed by the toilet goods department of the store.

Manufacturers, in other words, are asked to hold the bag.

Usual extra discounts to the store will be continued.

Manufacturers who now get paid by department stores for their merchandise in ten days will hereafter keep on consignment in the department store warehouse from \$1,000 to \$3,000 worth of their products, according to the number of products in the manufacturer's line and the popular demand for his product.

If this plan is accepted, he [each manufacturer] will be obliged to keep on permanent consignment at all times approximately \$1,000,000 worth of his products in the department stores of the United States.¹⁹

Chains demand and sometimes get manufacturers to make special orders for them at special prices. The purchasing agent for the X Drug Company told a wash-cloth manufacturer that his company was putting on a special sale of wash cloths and he wanted a rock-bottom price that would "knock competitors cold." The manufacturer quoted five cents per cloth as being the lowest price he could offer, and said that even so he would probably get into trouble with other dealers who handled his merchandise. The purchasing agent said that he did not care what brand was on the cloths, but that he wanted the cloths at a cost of not more than three cents. In compliance with this request, the manufacturer produced the specified order of unbranded cloths and sold them at three cents. The time preference in the sale of an article which chains are sometimes accorded is usually in those cases where the chain's buying de-

¹⁹ Editorial, *Drug Trade News* (February 27, 1928).

partment has created or helped design the product. Not until later are competitors allowed to stock this item.

As far as most drug chains are concerned, suppliers are not conferring much of a favor on them by furnishing window-display material. The chains rarely use such material because it is not made to fit their individual windows and their methods of window display. Though the purchase contract between chain and manufacturer does not necessarily provide that the chain may cancel its orders, it is usually understood that this may be done. The purchasing agents of two drug chains condemned this practice as being unethical and economically unsound. They maintain that the manufacturer should not be made to bear the burden of market reverses by having goods refused, and thus have to take huge inventory losses. Some chains do this, however, and though the courts would probably refuse to sanction this procedure, the manufacturer weakly submits for fear of losing future business of the chain.

THE DRIVE FOR PRICE CONCESSIONS

The co-operation between most drug chains and the manufacturers from whom they purchase is remarkable. The chains have learned that by co-operating with the manufacturer they are much more likely to be given special treatment. The manufacturers, on the other hand, are so greatly impressed and pleased with the efficiency and sales volume of the chain unit as compared with the average independent drug store that they are inclined to treat the chains in such a manner as not to lose their favor. Despite this co-operation, there is bound to be friction and antagonism. Chain buyers are under constant pressure to secure merchandise at lower and still lower prices in order that the chain may attract the public by offering prices lower than those of competitors. Chain buyers are notorious for their efforts to force the manufacturers' prices down and for the success which attends these efforts. *Advertising and Sell-*

*ing*²⁰ reports one chain that pays its senior buyers \$5,000 in salaries, but makes it possible for them to earn two or three times this amount in buying commissions, \$15,000 being no unusual bonus. The buyers receive this bonus as a percentage of what they save the company by buying merchandise at a price below what the manufacturer asks for it. Thus buyers are interested personally in beating down the price, and to do this play one competitor off against another.

It is certain, though some buyers deny it, that chain buyers use all the pressure at their command to secure the greatest possible concessions from suppliers.²¹ The tremendous buying power of many of the drug chains and the quasi-monopolies which some of the drug chains exercise in one or more markets are such powerful weapons that it becomes exceedingly difficult for many, and impossible for some, manufacturers to resist this pressure. For example, unless the manufacturer secures distribution through the Liggett stores in New York, he has not begun to cover the market. The same is true of the Walgreen Company in Chicago, the Peoples Drug Company in Washington, the Owl Drug Company in San Francisco and Los Angeles, and the Dow Drug Company in Cincinnati. The following two letters will serve to illustrate the manner in which chains sometimes bring pressure to bear on their suppliers to secure lower prices. Though these letters do not happen to be from drug chains, they are fairly typical of the buying strategy employed:

To ———:

The Board of Directors of this Corporation has decided to uniformly apply the same cash discounts that we are receiving from many houses to all concerns from whom we purchase without exception, after April 16th next. Three %—10 days—30 days extra. It would be manifestly unfair

²⁰ "Why Chain Buyers Are Expert at Beating Down the Price," *op. cit.*, XV, No. 13 (October 29, 1930), 28.

²¹ See also J. M. McDonald, "How We Protect Our Sources of Supply," *Sales Management*, IX, No. 1 (July 11, 1925), 13 ff. An interview reported by R. W. Johnson.

to give preference in purchasing merchandise to any concern not allowing the same terms as above noted as many others do, and hence the Board of Directors has decided to adopt these uniform terms.

Very truly yours,

McCRORY STORES CORPORATION²²

GENTLEMEN:

We are planning a special drive for business during May, June, and July, and contemplate buying heavily in your particular line with an idea of increased volume.

It will be necessary for us to make a great many sacrifices and instead of asking for specially made or specially priced merchandise, we are going to push our regularly listed lines. You can coöperate with us by extending a 10% special discount on all goods ordered or shipped during May or June, and we would appreciate approval by you in return mail, as we are holding up a number of orders pending your reply.

Very truly yours,

ISAAC SILVER AND BROS. CO. INC.²³

These letters are typical of the methods employed by the drug chains, though usually the pressure is brought to bear not through letter but by the buyer in personal conference with the seller or his agent. The letters imply large impending purchase orders, and the manufacturer is led to believe (and it is probably the truth) that his own volume will be permanently increased if he meets the chain's terms, whereas if he does not, orders will go to competitors. It is said that the procedure used and the results obtained by the purchasing department of one large drug chain are somewhat as follows:²⁴

The salesman for the manufacturer or his representative comes to the chain and is given an interview by a buyer. If the product is one that the chain would like to handle, the buyer speaks in glowing terms of its sales possibilities and probable volume in the company's stores. The very mention of the probable size of the order, should it be given, is dazzling to the manufacturer's salesman or representative, especially if he has

²² *Drug Trade News*, April 23, 1928.

²³ *Ibid.*, May 21, 1928.

²⁴ Source not quotable.

not dealt with large drug chains before, and he is ready to do almost anything to secure that order.

Finally, the huge order is given with promises of more like it if the merchandise sells. Then terms are discussed. The buyer gets the very lowest possible price and the best terms—and he may find it desirable to call in the executive in charge of all purchases, who is an expert in securing price concessions. Then the salesman is taken to see the advertising manager, who extracts 1 or 2 per cent of the amount of the order for advertising. Next the display manager is consulted, and he may secure a little donation for special display material to help put the merchandise across. And, finally, the sales manager may extract a little cash to pay extra commissions or for prizes for sales contests. When the salesman finally gets away and has a chance to figure out the results of his order, he is likely to find that he is paying the company to handle his product. This account may be slightly exaggerated, but it is suggestive of chain buying tactics.

A manufacturer who is dazzled by volume deserves little sympathy for any treatment he gets at the hands of chain buyers. Manufacturers' salesmen are sometimes dazzled by the unexpected size of the order placed by the chain. One such salesman called upon the buyer of a large drug chain to solicit an order of dust mops. He was told that one thousand of these mops would be taken on the first order, provided: (1) that the price of the mop to the chain be reduced enough to enable the drug store to sell the mop at approximately \$1.00 and still make the usual profit on such items (about 40 per cent gross); (2) that the construction of the handle be changed so that it might be packed in sections in a small, compact package; (3) that the mop company pack each mop in a separate box ready to be sold in the stores without any further packing or unpacking by the chain; (4) that the mop company purchase from the chain a bottle of mop oil, one bottle to be packed with each mop. It is

not known whether the manufacturer could meet all these conditions and still make a profit, but the salesman soliciting the order had no hesitancy in recommending to his company that it be accepted.

Manufacturers are very foolish to attempt to deal with any chain without some knowledge about that firm's business and possibilities, or to send inexperienced salesmen to deal with the chain. The writer chanced to be in the waiting-room of the Walgreen Company's general office seated next to a salesman who was waiting to see one of the buyers. The salesman inquired about the Walgreen Company as to the number of its stores, what merchandise it handled, where its stores were located, what volume the company did. He seemed totally ignorant about the company, but someone had told him that if he could see a Walgreen buyer he would probably secure a large order. His being unprepared to match wits with an intelligent Walgreen buyer did not deter him from making the attempt.

Thus far the chains' buying tactics have succeeded remarkably well, and though manufacturers often become incensed at their demands, few have openly revolted and most of them continue to co-operate fully. A statement by the head of the purchasing department of one drug chain shows how well this company has succeeded in its relations with suppliers. He says that many manufacturers are glad to sell his company merchandise at cost because this increased volume means a reduction in overhead which allows the manufacturer to make greater profits on the remainder of his sales. He states, for example, that he is able to buy ice-cream and many other fountain supplies at far less than it would actually cost his firm to manufacture them, the same quality and uniformity being considered.

The following questionnaire, which one drug chain requires every supplier to fill out before a purchase agreement is

reached, illustrates some of the amazing concessions expected. The questionnaire further confirms the character of the demands which chains make upon suppliers.

THE "X" DRUG COMPANY
PURCHASING QUESTIONNAIRE

GENTLEMEN:

Refer reply to.....

Kindly answer each of the following questions in detail as it is necessary we have this information before issuing orders for merchandise to your company:

1. If you sell not more than five items, please state below the name of each item, the various sizes—and state your list price to Dealers and your suggested advertised retail selling price.

Name of Item	Size	List Price to Dealers	Your Suggested Advertised Retail Selling Price
a)			
b)			
c)			
d)			
e)			

2. If you sell more than five items, instead of answering the question above, please attach twelve printed lists showing items and list price to Dealers, also your suggested advertised retail selling price in the twelve printed lists.

3. Describe fully each article, and if a medicinal preparation state whether it is a Liquid, Tablet, Ointment, or Salt.

f)	i)
g)	j)
h)	

4. State purpose for which each item listed above is used.

k)	n)
l)	o)
m)	

5. State minimum amount necessary to purchase in order to receive your maximum Service Wholesaler's Discount.....
6. State your maximum Service Wholesaler's Discount.....
7. State what extra discount you will give the "X" Drug Company beyond your maximum Service Wholesaler's Discount.....

8. State Cash Discount.....
9. Will you allow us to make payments between the 15th and 25th day of each month for the preceding month's purchases, we deducting the cash discount at time of payment? (Owing to the fact that it is practically impossible for us to receive merchandise, check same against invoices and pass invoices through our Auditing Department within less time than above stated, it is necessary for us to make this request.)
10. If the quantities you require the Wholesaler to order are in excess of our requirements, may we have the privilege of purchasing in any quantity and receive your maximum discounts until such times as our requirements warrant us purchasing the required amount or more?.....
11. *a)* We have Warehouses in ———, ———, and ———. Will you make deliveries direct free of charge to said Warehouses?.....
- b)* We have Stores in over ——— hundred Towns and Cities in the United States. Will you make deliveries free of charge to these Stores, and in any additional Towns and Cities in which we may locate?.....
- c)* We sometimes run low on merchandise and authorize the supplier to ship by Express. Will you ship F.O.B. Destination?.....
- d)* If you deliver F.O.B. Freight Station or Pier in Towns and Cities in which we are located, will you allow us 15c per hundred pounds for local cartage?.....
- e)* If you cannot subscribe to any of the above, what are your best transportation terms?.....
12. Should you increase or reduce prices quoted in this questionnaire or printed price list submitted, will you agree to notify us prior to the date the new prices become effective?.....
13. If for any reason the sale of your items does not warrant us to continue stocking same, or if at any time we have on hand in our Stores and Warehouses overstocks of your items, will you agree to accept same back from us for credit—and credit payable in cash if so desired by us?.....
14. Should you reduce prices quoted, will you credit the "X" Drug Company with the difference between the old and new costs covering stocks on hand in our Stores and Warehouses?.....
15. Do you agree that any merchandise from you is delivered by you on guarantee as follows: You guarantee that your merchandise will comply in all respects with all Municipal, Federal, and State requirements

and regulations, including the requirements of all Boards of Health or subdivisions of any Municipal, State, or Federal Governments, and you especially guarantee that your merchandise will comply with the Pure Food and Drug Act or Acts (and any amendments thereto) of the United States, the District of Columbia and the respective States and Municipalities and that your merchandise is not and will not be adulterated or misbranded within the meaning of the Pure Food and Drug Act or Acts (or amendments thereto) of the United States or of any State, District, or Municipality in which such merchandise is or shall be sold; and that all such merchandise will comply with the laws and regulations of the United States, and the States, Districts, and Municipalities thereof governing weights, sizes, standards, and markings, and with the requirements of all other laws and regulations applicable to such merchandise?.....

16. Do you agree that any merchandise received from you is delivered by you on guarantee and agreements as follows: You guarantee that your products and merchandise do not infringe any patent, trademark, trade-name, or other exclusive rights and you agree to protect and indemnify the "X" Drug Company against any claim, damage, liability, judgment, loss or expense, of any kind, on account of any infringement or asserted infringement or any patent, trademark, trade-name, or other exclusive rights arising from the sale to or by the "X" Drug Company of your merchandise; in event any claim should be made against the "X" Drug Company on account of any such infringement or asserted infringement you agree to handle same without expense to the "X" Drug Company, and in case any suit should be commenced against the "X" Drug Company, written notice thereof should be given to you at your office address, by the "X" Drug Company, with copy of any process served upon the "X" Drug Company, and you will agree to defend the same without expense to the "X" Drug Company, and to protect and hold harmless said Company from loss, expense, or damage of any kind on account of any such claim or suit. You also agree to protect and indemnify said "X" Drug Company against any loss, costs, expense, judgment, damage, or liability resulting from injury to any person or property by reason of the use or handling of any of your products or merchandise, it being understood that upon commencement of any suit, written notice thereof shall be given to you at your office address, by the "X" Drug Company with copy of any summons or other process served upon said Company?.....

17. This questionnaire is not to be construed as an order. All orders are issued by this Company on regular numbered order blanks. In case orders are issued to and accepted by you after the date hereof by the "X" Drug Company, the agreements in paragraphs 15 and 16 constitute a part of the contract or contracts between the "X" Drug Company and you relating to the merchandise, and all other agreements herein made by you shall constitute a part of such contract or contracts unless modified or withdrawn by notice given by you to the "X" Drug Company previous to the issuance of order.
18. This purchasing questionnaire is sent to you in duplicate. Please sign and return original copy to us, and retain duplicate for your files.

Please sign here

Very truly yours,

Name of firm.....

"X" DRUG COMPANY

Address.....

By.....

[*official title*]

By.....

Date.....

[*Purchasing Department*]

It must not be construed from the discussion that the chain possesses complete power over the manufacturer in buying, because this is not the case. The manufacturer also possesses certain powers which he can use to compel the chain to accept his terms and handle his commodities, but in the main his position is not quite so strong as that of the chain. The most powerful weapon which the manufacturer has is consumer demand, which he may establish through national advertising. He is protected to some extent by patents, copyrights, trade-marks, and package designs against undetected substitution. These are about the only weapons the manufacturer has, aside from that of establishing his own retail outlets.

These weapons, however, must not be underrated because they can be made very effective. Two outstanding examples may be cited in the drug trade. The first is Listerine. This product would not be handled in many chains or independent drug stores under the present conditions of sale if the demands by customers did not make it necessary. The strength of the

demand created for this product by national advertising is so great that many chain drug stores feel compelled to give it counter displays. Prospective customers have been known to walk out of stores because they failed to see a price-marked display of this product, consequently all prospect for the sale of other merchandise to these individuals was lost.

Listerine is so popular that its sale is almost profitless to the retailer because it is being used as a loss leader in some drug stores all of the time. Indeed, so closely do customers watch its price that they usually refuse to buy it at a slightly higher price in one store than they have seen it advertised elsewhere; hence this price competition must be met. But even with such tremendous pulling power, the sales of this mouth wash could probably be increased somewhat by the active co-operation of chain drug stores. The manufacturer cannot force the chain to feature Listerine in its advertising, or to give it window displays, or, in all cases, counter displays, or to have clerks recommend it. As a matter of fact, most of the chains handle several competitive mouth washes, among which is usually one of their own brand. This latter is featured and displayed and recommended by clerks on every possible occasion. Thus, while it is almost impossible for the clerk to make a substitution for Listerine to a Listerine fan, it is certain that those who are undecided or who rely on the clerk's judgment do not buy Listerine in chain drug stores.²⁵

A second case is that of Bayer's Aspirin. Even though the trade-name "aspirin" has been thrown open to competitors, it is next to impossible to substitute any other brand. The far-flung national advertising of the manufacturer of this product, coupled with the distinctive package in which it is packed, accounts for the consumer demand that forces the chain drug stores to handle it. In this case cut prices are not a large factor,

²⁵ This may not be true in every chain drug store, but from tests conducted and statements made by chain officials, it must be true in most of them.

for the price charged for Bayer's Aspirin is almost uniform. But because the manufacturer allows the chain no great discounts on prices, the profits realized on its sales are very small. For this reason nearly every chain drug company has its own private brand of aspirin tablets identical in content with Bayer's because the aspirin formula is governed by the United States Pharmacopoeia. In addition, the sales price of the private brands is invariably less than Bayer's, and yet it remains almost impossible to sell anyone demanding Bayer's any other brand. This company, too, is undoubtedly losing some sales through the hostility of chain stores who substitute whenever possible and who advertise, display, and recommend their own brands. At one time Liggett clerks made determined efforts to substitute the company's own brand of aspirin when customers asked for Bayer's, but customer hostility forced an abandonment of this practice. Since Drug Incorporated has purchased the Bayer Company, Bayer's is naturally featured in Liggett stores.

Independent merchants also institute retaliatory measures against manufacturers when they feel they have a grievance. In one independent drug store it was observed that no Kotex was on display, though large quantities of Modess were. When the owner was questioned about this, he pointed out the fact that the policies of the manufacturer of Kotex were such that little profit was realized on its sale; so he wrapped all packages of Kotex (because demand forced him to carry it) and placed it back of the Modess display, where it could not possibly come to the attention of the customer, but was available when called for. Drug chains are also known to use this method of discouraging the sale of certain products.

These illustrations indicate that if a manufacturer is prepared and willing to spend the necessary funds to establish a consumer demand that cannot be successfully resisted, he is in a better position to dictate his terms to the chain stores. Even so he loses many sales, because he cannot compel the stores to

feature or display his products. His net profits may be more satisfactory, however, than they would be if he made the price concessions necessary to get the chain's full co-operation.

CO-OPERATION BETWEEN CHAINS AND SUPPLIERS

It has previously been mentioned that the drug chains and manufacturers co-operate with each other in many ways. Some of the additional important forms of co-operation are the following:

1. Chain buyers co-operate with the manufacturer in the creation of new products or of new designs for old products. The chain is in much closer contact with the consumer than the manufacturer, and for that reason is aware of changes in demand before the manufacturer is. By passing this knowledge back, the chain helps the producer to avoid losses, both in the further production of merchandise no longer wanted in the market and in the loss of sales that results when the manufacturer's products are not modified to meet changes in market demands without delay.

2. Chains sometimes co-operate in price maintenance. Chain drug stores are usually known as cut-rate stores and perhaps properly so, since one of their constant appeals is the low-price appeal; yet two out of the four drug chains studied have declared that, if they could, they would do away with loss leaders and the fierce price competition which is now current in the business. The chains charge the independents with being the leaders, in many instances, in price wars and price competition. The independent dealer is often ignorant of his actual costs and sometimes sells merchandise below actual cost without knowing it—a practice which plays havoc with other drug stores, including the chains, because they must meet competitors' prices. Again, independents attempt to meet what they believe to be the chains' chief competitive weapon, price, and indiscriminately cut to such an extent that many items are sold without any profit at all. At least two of the drug chains make

sincere efforts to maintain profitable prices, but find it impossible to do so on many items, not alone because of independent druggists, but because one of the larger drug chains is a consistent and ruthless price-cutter and all the other chains feel compelled to meet this price competition.

There is little question that the price situation in the drug trade is chaotic, especially in certain centers, such as Kansas City, Denver, and Chicago. In both Kansas City and Denver the disastrous price situation has not been created by the national chains, but by local drug companies whose prices the large chains have been forced to meet. The differences in prices on the same articles charged by the same drug company operating in the three cities named and other cities are in some cases as much as 10, 20, and 30 per cent. Such price conditions have been one of the strongest motives for chains' establishing their own lines of products, the prices of which they can control.

So keen is price competition in the retail drug field on branded products that at least one drug chain, the Owl Drug Company, has adopted a new policy, which it is testing in certain cities, of meeting the prices not only of drug-store competitors, but of any outlet handling any product which Owl stores handle.

The chain executive does not like to discuss price maintenance because of the constant watch kept by the Federal Trade Commission, but officials of every one of the four drug chains admitted that if a manufacturer asked them to maintain prices, they were only too glad to do so, provided that he got all competitors in the same market to do likewise. As soon as any competitor of importance cuts the price, however, the agreement is canceled, because every drug chain feels bound to meet the price of all competitors.²⁶

²⁶ For an interesting case of attempted price maintenance in the retail drug trade of New York City see the case of the New York Pharmaceutical Conference, Inc., in Federal Trade Commission, *Annual Report* (1927), p. 44; *ibid.* (1928), p. 144. Details are given in mimeographed report, Docket 1392.

3. Suppliers frequently co-operate with the chains in conducting sales campaigns. The life of the chain drug store seems to be one sales campaign after another, and in these campaigns many manufacturers co-operate. This co-operation takes many forms, from supplying special merchandise at special prices to providing funds for commissions and prizes for salespeople. During the drive the manufacturer may put on a special advertising campaign, and the chain often gives the merchandise special window and counter displays.

4. Manufacturers aid the chain in training salespeople. They provide speakers, moving pictures, and printed matter which explain the manufacturing processes and the sales points to be stressed.

THE CASE OF THE INDEPENDENTS IN BUYING

Despite the fact that the independent has an important weapon in buying at his command, namely, co-operative buying, and granting that the buying advantages of chains have been overestimated, the discussion would seem to indicate that chain drug companies do possess a decided advantage over the independent. The vice-president in charge of purchasing for the Liggett Company believes that a good deal of the handicap under which the independent labors in regard to concessions from manufacturers is his own fault. He says that the typical independent refuses advice and help from the manufacturer, being sure in his own mind that he can run his own business and consequently resenting what he considers interference. His windows contain a collection of junk, and valuable space is given over to poor or offensive merchandise, much of which ought not to be carried, let alone displayed. This official believes that if the independents appealed to the manufacturer for aid and co-operated to the extent that the chains do, they would be treated as well as the chains are, for manufacturers realize that they must still depend on the independent retailers for a large part of their distribution.

Investigation of a limited number of independents would seem to justify some of the conclusions set forth above, though they may be somewhat overdrawn. It is doubtful if any one independent would be accorded the same treatment as the chains; however, there is little question that a strong independent druggists' association would be able to get results and concessions from manufacturers by concerted action.

The following quotation from a trade journal, catering to independent druggists in the main, gives the views of one who is in sympathy with the independent:

There are others [handicaps], and among these and probably chief among them is the indifference of the average manufacturer to the fast turnover items, the lack of appreciation of the wide distribution their wares have in the independent stores. They are indifferent because they perhaps feel that the men in this group are unorganized and are consequently helpless to retaliate, and that resentment will be all that they will have to encounter. They evidently have weighed the matter and decided to go out after volume, ignoring the resentment which crops out in spots. *In the scramble for greater and greater distribution the manufacturers have made such great concessions in prices to certain customers that others who purchase their wares in usable quantities are so outclassed as to be forced out of the race.*

It is not an unusual thing to see many of those advertised items offered in one store at retail at a figure lower than the jobbing price, or even lower than the price to the jobber, while the independent competitor is left to take his choice in disposing of like items; either he may meet his competitor's price and lose money, or refuse to meet it and sell none of these goods and consequently lose money. It is heads I win, tails you lose.²⁷

The independent druggist has a basis for some of the complaints he makes against certain manufacturers, wholesalers, and chain drug stores. The manufacturer accords secret discounts to competitors of the independent druggist. How can the independent act to meet the requirements necessary to se-

²⁷ A. L. I. Winne, "Must the Independent Druggist Make His Own Goods?" *American Druggist*, LXXVII, No. 1 (January, 1928), 26-27. The italics are the writer's. The article goes on to suggest remedies for the situation described.

cure such discounts when their amounts and the reasons for which they are given are kept secret? The independent believes the manufacturer attaches too much importance to chain outlets. After all, the independent still sells approximately 80 per cent of the merchandise sold by all drug stores, and operates from 90 to 95 per cent of the total number of retail drug stores.

The wholesaler (and manufacturer as well) has not come to the aid of the independent druggist in his struggle with competitors in the way the independent retailer believes that he should. The retailer believes the wholesaler, with his greater financial stability and the greater advantages which he possesses for collecting market information, is able to furnish aggressive leadership in the struggle for markets if he so wishes. In not doing so, the wholesaler has neglected an opportunity which he cannot afford to neglect since his own welfare is bound up with that of his independent customer.

The independent druggist also complains about the failure of the manufacturer to protect him against destructive price competition. He can cite many instances in which chain-store competitors are selling products at retail for less than the independent druggist can purchase them. In some cases, no doubt, the manufacturer is responsible for destructive price-cutting, since his price policy has resulted in such situations. On the other hand, the independent himself has often been the aggressor in such price competition. There is no practical legal way in which a manufacturer can actually prevent destructive price-cutting, although the price policies which he adopts tend to maximize or minimize the practice.

One of the independent's most important problems in connection with buying, aside from the price, is that of selecting merchandise of the sort which will sell and net him a profit. The chain drug stores net their profits on their own brands which they control, and on fast-moving sundry and novelty items which they constantly change. Since the independent

usually controls no brands, he should go in heavily for the sale of novelties and sundry items on which price comparisons are not easily made by the customer and on which legitimate profits can be made. But being a professional rather than a merchandising man, most independents have difficulty in selecting the articles that will sell in their store, and also in buying the right amounts. It is here that an outside agency, such as the wholesaler, can be an aid to the independent. Of course, the wholesaler must think about the welfare of the independent rather than the size of the immediate orders he may secure, but in the long run their welfare is inseparable.

Unless the independents act to convince the manufacturers that they are still a factor, and an important one in the market, the drug chains are almost sure to increase their buying advantages as they continue to grow larger and become more powerful and dominating. And from some sources it has already been intimated that the manufacturer is in a receptive mood to co-operate with the independents as a protection for himself in his encounter with the chains. No wise manufacturer will depend wholly or even in large part upon a chain drug company for his retail outlets; otherwise he is likely to find himself in a position of accepting whatever terms are offered him by the chain or losing his entire market.

The writer had hoped to conclude this chapter by presenting price data showing the actual differential in the cost of specified articles to drug chains and independent druggists. Unfortunately, the data secured, although significant, are not adequate for the purpose in mind and have therefore been omitted. It is hoped that at some future time the chains will furnish more of this information than they have yet seen fit to do.

CHAPTER V

PURCHASING ORGANIZATION

THE PLACE OF PURCHASING IN CHAIN-STORE ORGANIZATIONS

The form of organization to carry on the purchasing activity varies with every company, but in each this department is one of the major departments with its head directly responsible to the chief executive. Since the chain is essentially a retailing organization, it seems entirely proper that the purchasing department should be a major department, for on proper buying depends successful selling. It is desirable, therefore, that the purchasing department be as free from interference as possible and that it receive the attention of the major executives.

It is possible to speculate on the best form of organization for the purchasing department. In this connection arises the old controversy as to whether the purchasing department should be made subordinate to the sales department or vice versa. It is argued that the sales department must dispose of the goods purchased and should therefore have a major voice in the choice of the goods which it must sell. There is no question but that in order to achieve the desired results the closest co-operation must obtain between the sales and purchasing departments. By placing one department under the other, however, there seems to be an erroneous implication that one is more important than the other.¹ Independence of action for

¹ J. O. McKinsey, professor of business organization in the University of Chicago, has said that a purchasing official has an entirely different mental make-up from that of the best sales officials. The former is cool, calculating, and inclined to act slowly and conservatively, whereas the sales official is inclined to be of the opposite nature. To place one under the other is likely to cause not only friction, but the giving of undue importance to the one activity as against the other.

both departments (within limits) seems vital to the best interests of the chain, and this independence seems lost when one is made subordinate to the other. The Liggett Drug Company attempts to secure co-operation of the two departments, at the same time allowing much freedom of action to each by making the purchasing department a distinct major department with power to recommend the purchase of commodities to the sales department. This latter department is placed under the control of a vice-president in charge of stores, and hence does not have the same rank as the purchasing department, yet is independent of it. In this instance the purchasing department probably dominates the sales department to some extent, but this is not necessarily the result of the form of the organization.

There are substantial reasons why it might be desirable to place both the purchasing and the sales departments under a merchandise manager, who would then act as a co-ordinator of these two functions and as a final arbitrator. In such an organization the sales manager and the purchasing agent would be directly responsible to the merchandise manager. These three together would constitute a merchandising board which would provide a method of obtaining co-operation and also a means of settling any disputes that might arise between these two departments.

Desirable as this plan seems, none of the four companies studied had such a form of organization. The Walgreen Company achieves the results of such a plan with a less workable form of organization. In this company the purchasing organization is entirely separate from sales. The manager of stores likewise has his own department. His work consists of the supervision of all sales as well as of store operations. Members of the organization sometimes speak of him as the "merchandise manager." Although he is not that, he tends to assume the functions of such an official. He cannot veto outright the decisions of the purchasing or advertising departments; he as-

sumes a leadership, however, and co-ordinates the work of the three departments so closely that it is unlikely that they would do anything which he actively opposed, unless the merchandise board, on which other major executives sit, should approve such action.² It is not unlikely that in time a plan of organization similar to that suggested above will evolve in this company.³

Another type of organization, used by two of the drug-chains studied, makes the purchasing department directly responsible for selling. In such an organization the head buyer is virtually the sales manager as well, and each buyer becomes an assistant sales manager for the products which he buys. This is true in a more limited way even though the company has a sales department, as in the case of the Owl Drug Company. Merchandise that piles up in the warehouse becomes a charge upon the ability of the buyer who purchased it. This form of organization is commonly used by department stores, each department manager doing his own buying. The chain-store buyer, charged with the selling function as well, directs that activity from headquarters by means of letters, bulletins, special campaigns, and personal visits to the stores. He typically does not supervise sales work personally in the store, because that part of the sales work is supervised by the store-operating department. Both the Owl (Chicago district) and the Buck & Rayner organizations are essentially of this character. For example, in the Buck & Rayner Company the head buyer was also merchandise manager and as such directed the purchasing and sales activities of each of his assistants. Each assistant was assigned certain commodities which he was to buy and the sale of which he had to supervise. The actual amount of sales super-

² This is the opinion expressed to the writer by several junior executives and store managers.

³ The Walgreen Company has recently (1930) changed the form of its headquarters organization, which at present is more like that suggested above than it was at the time when this investigation was made.

vision depended to a large extent upon the buyer's interest in this phase of his work.

There are several desirable features about this type of organization. First, it is likely that the official directly charged with the responsibility of selling will be much more careful in his selection of commodities and their amounts. Second, the official concerned with selling is likely to be in much closer touch with public demands and market conditions and hence is in a better position to know what merchandise to buy. Third, the purchasing official is likely to know all of the best points about a given article, and if he is in charge of sales he is able to make this information available to those selling.

There are weak points about the plan which tend to offset its advantages. First, the qualifications which go to make a good buyer are not necessarily those of a good sales manager; in fact, many are the opposite. Second, a buyer does not have the necessary time to devote to both buying and selling. To secure the best co-operation from manufacturers and to learn of new items quickly, a buyer should be available to salesmen at all times. He should have time to study commodities, markets, competing products, price trends, etc. Likewise, the sales-department officials must have time to devote to sales methods. One man trying to do both jobs, or a part of both jobs, finds it difficult to handle them and is likely to slight one or the other.

There is some question in drug chains as to whether purchasing should be centralized or decentralized. Should all the purchasing be done at one buying office by one organization, or is there some advantage in having more than one buying office? Centralized buying is usually taken for granted as being a fixed policy of chain systems, yet many chains maintain foreign buying offices besides the domestic ones. Aside from these foreign buying offices, the most common practice is to have only one domestic buying office. The Owl Drug Company, however, has three such offices. This chain has headquarters

on the west coast, and though its main buying is done there, the company finds it desirable to maintain a Chicago and a New York buying office. The latter is made almost necessary by the fact that New York is the only market in this country in which essential oils for perfume and toilet-goods manufacture can be secured.

The widely scattered units of the chain complicate the buying problems of the centralized purchasing departments, because it is extremely difficult for those at headquarters to visualize the varying conditions and demands in all the territory in which a company may operate. Commodities suitable for one section often have no chance of sale in another. Demand for commodities sweeps in waves across the country, usually from east to west, and it is often difficult for a headquarters office to follow these movements. Many sales are lost because products of only local demand are not carried by the chain units in that locality. Central headquarters is forced to depend upon the managers of local units for information of this kind and for facts as to local conditions. Such information is often inaccurate because it comes from those untrained in its collection.

Some chains (such as the J. C. Penney Company) try to secure the advantages of centralized buying and yet avoid its difficulties by making each of their store managers the actual buyer for his particular store, having him come to the market and buy from approved sources such commodities as he believes are in demand in his community. This plan overcomes some of the difficulties of the strictly centralized plan, yet its advantages are offset by the fact that the company loses some of the advantages of specialization, its buying costs are increased, there is needless duplication of work, and in the long run there is no guaranty against loss through the poor judgment of those who, of necessity, are less well trained in interpreting community wants than are those who devote their full attention to such problems.

The Owl Drug Company secures a certain flexibility to take care of sectional demands by allowing its store managers considerable leeway in stocking goods which they think are in demand in their territory. This has its obvious advantages and disadvantages. The Liggett Company, on the other hand, has a rather rigid standard list of commodities for all stores with slight variations for different sections of the country, but does not allow its managers any leeway at all (except on request) to change that list.

A decentralized purchasing organization is not desirable despite the advantages claimed for it. Such a plan introduces the difficulty of co-operation among the various buying offices, makes specialization less complete and its advantages fewer, increases the overhead costs of operation as well as the direct costs, and complicates the problem of supervision. The organization of the Owl Drug Company makes the situation clear. This company has three separate buying offices with no direct central authority to supervise and control the work of the three. Each office duplicates, to some extent, the work of the others; no one office can be completely specialized; each office is compelled to keep in constant touch with the others in order that each may know what the others are doing. This necessitates the transfer of messages and duplication of orders, all of which add to the cost and delay of the work.

Study of the various organizations seems to indicate rather clearly that a central domestic buying office for the drug chain is by far the better plan. It would seem wise to establish this office near the greatest source of supplies, which for the drug trade is undoubtedly New York or Chicago. This would be true even if the home office were located elsewhere. The small chain, unable to afford the maintenance of a buying office away from headquarters, would do well to employ a buying representative in these markets or to join a buying association maintaining headquarters in one of them.

INTERNAL ORGANIZATION

For the most part, drug chains' purchasing departments are organized on a commodity basis. Each buyer in the department is assigned a group of commodities, more or less related, in which he specializes.⁴ This specialization supposedly enables each buyer to become more of an expert than would otherwise be possible. Despite the fact that each buyer must usually handle a large number of different items, often of highly unrelated lines, this form of organization does allow for more complete specialization of the purchasing function than almost any other form. The Liggett Company insists that its buyers be prepared to purchase any commodity handled by the chain, but makes each buyer responsible for the purchase of certain commodities. The object of this practice is the assurance that the forced absence or the resignation of a buyer will not cripple the department unduly, for the other buyers will be able to take over the work until provision can be made for its permanent administration. Then, too, the head buyer must have a general knowledge of all the commodities bought if he is to supervise the department's work, and the company wants its buyers to be ready for that position should it become vacant.

Internal organization of the purchasing department may also be along territorial lines, one buyer (or more) doing all the buying for all the stores in one section, another for all the stores in another section, etc. Few, if any, are the cases where such a plan of organization is completely carried out, but various modifications of it appear in many chain organizations.⁵

The purchasing organizations of two companies, the Owl and the Buck & Rayner, illustrate the commodity type of organization with the purchasing department also virtually a sales

⁴ See Appen. I for grouping of commodities handled by each buyer.

⁵ See W. D. Darby, "Story of the Chain Store," *Dry Goods Economist* (82d year), No. 4382 (June 30, 1928), pp. 15 ff., and No. 4386 (July 28, 1928), pp. 17 ff.

department,⁶ though of course sales activities are in reality only a minor part of the department's activities. In addition, the Owl Drug Company has something of the territorial idea in its organization, for it maintains three buying offices and special merchandise is sometimes bought by one buying office for the stores in its territory.⁷

The Liggett and the Walgreen drug companies illustrate the commodity type of organization also, but these departments have little or nothing to do with the sales function, there being a headquarters sales department in each company. The Liggett Drug Company represents the extreme in this direction. The purchasing department is in direct charge of a vice-president. But this department does not purchase commodities without the approval of the sales department, which, though of lower rank than the former, is not directly subject to the control of the vice-president in charge of purchases. The idea back of this plan is to secure the consent of the sales department, which is charged with selling the goods, before any new goods are ordered. In this way the sales department cannot shift responsibility. This, however, does not relieve the purchasing department of the responsibility for carefully selecting the merchandise, for it will not recommend any merchandise to the sales department for approval unless the buyers are convinced that such merchandise has real sales prospects. It is likely that the sales department is very considerate of the recommendations of the purchasing department for several rea-

⁶ By "sales department" is meant, in this connection, a headquarters department so named. Of course, every chain has a sales department, for the retail departments are little more than sales departments. Some chains, however, have what are called sales departments which devote their entire attention to the promotion of sales.

⁷ E.g., the advertising of a certain product by a manufacturer in Chicago may be confined to the Chicago area and may create heavy demands for it there, but on the east and west coasts it may be almost unheard of. The purchasing department will want to supply Chicago-area stores but not those on the coasts.

sons, but the idea of making the two functions entirely separate is fundamental in the organization plan.

In addition to the sales and purchasing departments there is a third, called "merchandise control," which supervises the re-ordering of merchandise. This supervision is exercised only when the purchasing department has been notified by the warehouse or the stores to reorder stocks.⁸ Since the merchandise-control department functions as a check upon the amount that may be ordered, the work of the buyer in such a case consists largely of keeping abreast of any new terms of sale that might have developed since the last purchase.

SUGGESTED PURCHASING ORGANIZATION

The first step in setting up an organization is to consider the work which that organization must perform. In the purchasing departments of drug chains this will vary somewhat with the nature and size of the company, but the basic tasks remain about the same in all chains.

1. *The problem of price.*—The first problem is for the department to secure merchandise for sale at a price that will enable it to meet competition. It is one thing to secure merchandise and another to secure it at a price as low as, or lower than, competitors pay for it. Since the drug business is a cut-rate business, it is almost imperative that competitors' buying prices be equalled; otherwise competitors' sales prices cannot be

⁸ The department of merchandise control is in charge of the merchandise manager, who reports directly to the vice-president in charge of finance and real estate. Its sole duties have to do with the control of investment in store and dépôt stocks. All purchase orders (excepting for new merchandise) originate in either the warehouse or the stores. Those coming from the former pass through the buying department for approval and then to the department of merchandise control where the size of the order is finally approved. This department also inspects all orders originating in the stores (intra-company) and handles the actual dispatching of all orders to suppliers. Since the department establishes standards of stock investment for each unit in the chain, its approval is based upon whether these standards are being maintained.

met without loss of profit. This is a particularly serious problem for the small chain.

2. *The problem of merchandise selection.*—What kind of merchandise shall be sold in the company's stores? This is a daily problem since changes are constantly necessary. It also becomes one of eliminating old items for which the sales volume no longer justifies their being carried. Space is so valuable in the store and sales efforts so scattered that no addition to the merchandise carried should be allowed without careful consideration, even though the goods are selected only for trial.

3. *The problem of securing new, attractive merchandise on time.*—Not only must merchandise with sales possibilities be selected, but new merchandise (especially the all-important novelties and sundries) must be acquired in time so that the company will have them on sale before or at the same time as competitors, and before the novelty has lost its appeal to the consumer. Fads change so quickly that any delay means the loss of the most profitable business with the further possibility that the stores will have quantities of the stock left on hand after demand for the item has ceased. In this connection the design of new commodities or odd novelties is very important. The manufacturer usually allows the chain a time preference in the sale of items designed by the chain's purchasing agent, though it refuses to allow the chain to control the sale of such items. Thus the chain is given an advantage over competitors for a limited period.⁹

4. *The problem of supply.*—An adequate supply of merchandise should be kept on hand at all times. The purchasing de-

⁹ E.g., the sales manager of the Liggett Company conceived the idea of a giant candy sucker. There have always been candy suckers, but this one was a huge one and was called "The Biggest Sucker in Town." It became very popular in the company's stores and thousands were sold, the demand being greater than the factory could satisfy. Competitors got them later, but the cream of the business was gone and the demand soon died down.

partment usually controls or is in direct contact with the warehouses and is charged with seeing that enough but not too much stock is on hand at all times.

5. *The problem of changing demand.*—Changes in consumer demand should be anticipated. Since demand is likely to shift overnight, the department has this problem to contend with. It must, so to speak, keep its ear to the ground for any signs of change in demand and be prepared to make drastic alterations in its merchandise from time to time in line with these changes.

6. *The problem of varying market conditions.*—Market conditions must be studied. Keeping abreast of price trends in the market and becoming cognizant of the specific price changes of given commodities and the probability of a falling-off in company sales are all necessary parts of the work of an efficient purchasing department. Negligence in any one of these respects will seriously affect the results obtained.

7. *The problem of finding sources of supply.*—This problem involves a knowledge of world-markets, transportation and tariff costs, and quality of merchandise. The department not always, but often, has more than one source of supply for given commodities, and it should obtain supplies where prices are lowest in relation to quality. It may find it necessary to create a source of supply when a satisfactory one is not available. It may also find it necessary to protect a source of supply against competitors. This protection necessitates allowing the manufacturer a price at which reasonable profits can be made or the manufacturer's bankruptcy may be involved and the source of supply lost. Most chains make it a rule to deal only with established concerns which are financially responsible. Purchasing contracts often call for a return of merchandise to the manufacturing company, if such goods are difficult to sell. For this reason fly-by-night concerns which are seldom financially reliable are unsatisfactory to deal with. Furthermore, once the

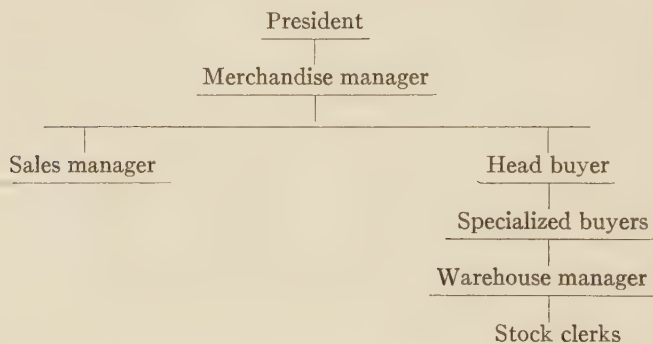
chain has helped to create a demand for a product, it does not want to assume the risk of losing the source of supply.

8. *The problem of co-ordinating purchases and sales.*—For effective work some co-ordination is necessary between the selling and the purchasing departments. This is always an important aspect of the purchasing department's work, because the department cannot act intelligently unless it can secure timely information with regard to sales.

There are, of course, many other problems common to all purchasing departments, and each one of those listed above involves a series of minor ones, but they do not to any great extent concern questions of organization.

Following is a suggested plan of organization for the purchasing department of a drug chain. This plan attempts to

SUGGESTED PLAN OF ORGANIZATION



stimulate co-operation between the purchasing and sales officials without making one subordinate to the other. The work of the merchandising department (as the combined functions might well be called) is headed by a merchandise manager who is directly responsible to the chief executive of the company. This man should be well versed in both buying and selling and his work will be one of co-ordinating the efforts of both the divisions under him. The work of the purchasing department

will be that of recommending that certain merchandise be handled, securing all the information about that merchandise, negotiating the terms of purchase, and placing all orders. The sales department will be concerned with approving or disapproving the recommendations made. It will also make requests for certain merchandise which has not come to the attention of the purchasing department, or merchandise for which the stores have had frequent calls, or which the purchasing department has rejected. Any disputes or disagreements as to the merchandise that should be handled will be settled finally by the merchandise board, which should consist of the merchandise manager, the purchasing agent, the sales manager, and one or more of the general executives. This board should also be an important factor in formulating policies of the departments, in planning courses of action, and should be a means of thrashing out the merits and demerits of particular commodities.

Under the head buyer, who will himself do much of the buying, especially when new merchandise is being considered or when some unusual purchase contract is to be made, there will be other buyers who will specialize in certain commodities. The commodities assigned to each buyer should be as closely related as the great variety of products will allow.

The warehouse should also be placed under the purchasing department for the reason that the department will be charged with regulating the amount of stock carried and seeing that necessary stock is always on hand. The warehouse clerks will keep the record of stock movements and will make out the re-order requisitions when the amounts on hand indicate that this should be done. This requisition will then go to the sales department for approval, in order that this department may indicate information which it may have as to any likely change in demand for this merchandise. If a decrease in sales is anticipated, a smaller order should be placed; in case a sales campaign is to be conducted, a larger order will be necessary. The re-

order then goes to the purchasing department, where new terms may be noted, adjustments in the size of the order made, and the order placed in regular routine.

There are one or two disadvantages in a plan such as the one outlined above. In the first place, it slows down all procedure in purchasing, and the time element is often important. The information and samples supplied by the purchasing department to the sales department call for further consideration, which takes additional time. In the second place, it makes the purchase of distress merchandise almost impossible, unless it be made under special rules, which are likely to upset the whole plan. The Liggett Company, which operates under a plan similar to the one proposed, does not believe in the purchase of distress merchandise at home or abroad, so it claims, and this seems generally a good policy to follow, for distress merchandise often proves to be anything but a bargain. Yet there are times when such merchandise is obviously a good purchase. In such cases it is necessary to trust to the judgment of the buyer, who will have to take full responsibility for anything purchased.

In the third place, the purchasing department is not in so good a position to carry out its promises to manufacturers under this plan as when it acts as the sales department also. Since manufacturers continually complain about the failure of chains to carry out agreements, this point deserves special emphasis. The purchasing department must have the necessary information and authority to see that promises of cooperation which it makes to suppliers are faithfully carried out. The means for the accomplishment of this purpose ought to be readily available if the merchandise manager is properly coordinating the work of the two departments. Fourth, it appears that since all sales responsibility is removed from the purchasing department, the buyers will be less careful in the selection of merchandise. But since the buyers merely recom-

mend merchandise which must have the final approval of the sales department, this objection is largely eliminated. As a matter of fact, because the tendency will be for the sales department to depend on the purchasing department's recommendation, the work of the latter should be just as thorough and careful as though its recommendations were final.

Finally, under the plan suggested, it is likely that the purchasing department will be further removed from the consumer, for its sales information will come to the purchasing department second hand rather than first hand, and the response to changes in demand may not be so rapid. With the providing of such close co-operation with the sales department, it is difficult to see how this indirect method of obtaining sales information can prove a very serious problem.

APPENDIX I

COMMODITY CLASSIFICATION
IN PURCHASING DEPARTMENTS OF CHAIN
DRUG COMPANIES

Commodities are grouped as follows for handling by the buyers. In the larger companies a buyer may have one or more assistants.

BUCK & RAYNER

Head buyer

General supervision over all commodities

Special attention to new commodities

Assistant buyer

Patent medicines

Toilet goods

Sundries

Rubber goods

Paper and twine

Assistant buyer

Candy

Cutlery

Toys

Assistant buyer

Chemicals

Soda-fountain supplies

Assistant buyer

Printing

Stationery

NOTE.—Tobacco handled as a concession; consequently no buyer for such products.

OWL DRUG COMPANY

General purchasing agent [San Francisco]

General supervision over all buying offices

In the Chicago office the following division obtains:

Purchasing agent

Supervises all buying

Delegates routine ordering to subordinate buyers

Buyer

Drugs

Chemicals

Supplies

Buyer

Sundries

Buyer

Patent medicines

Toilet articles

NOTE.—Tobacco products contracted for by other buying offices.

WALGREEN COMPANY

Head buyer

Supervises and advises assistant buyers

Passes on all new merchandise

Two assistant buyers

Make routine purchases not specifically delegated to other buyers

Assistant buyer

Tobacco products

Assistant buyer

Laboratory supplies

Raw chemicals

Pharmaceuticals

Assistant buyer

Printing

Stationery

Assistant buyer

Perfumes

LIGGETT COMPANY

Vice-president in charge of purchasing

General supervision of all buying

Specialist in forecasting market prices with particular attention to raw products

Buyer

Proprietary

Medicinal

Pharmaceutical

Buyer

Soda-fountain supplies

Food products

Buyer

Toilet goods

Fancy goods [sundries]

Buyer [registered pharmacist]

Hospital goods

Confections

Toys

NOTE.—The company has its own subsidiary handling tobacco products.

APPENDIX II

ADVERTISING ALLOWANCES

The following summary of an article by H. A. Haring, "‘Allowances’ to Chains Are Mulcting Advertisers of Millions," *Advertising and Selling*, XVI, No. 7 (February 4, 1931), 18, is included in this study because of the specific information which it contains regarding a practice which seems to be spreading.

A maker of women's toilet goods spent \$2,218,000 for space (in the usual accepted media for advertising) in 1928 and \$2,150,000 for "allowances"; in 1929 the figures were \$1,890,000 and \$3,400,000, respectively; in 1930, about \$760,000 and \$3,500,000. The space went down, the "allowances" up, "because we could cut off space by telephoning our agency but either had to play ball with the 'allowances' or quit business."

A maker of smokers' accessories can spare only \$86,000 for space but staggers under a burden of \$422,000 for "coöperation," the major portion of which goes to three chains. Volume of sales goes steadily up, net profits down. For 1931 "we'll just about keep our face in the trade papers," they say, "that's all."

A maker of floor coverings with "about \$100,000" for space doled out "five or six times that much" to furniture and similar chains in 1930. A tire maker, with only 30 per cent of sales through chains, made "allowances" to them in excess of what was expended for space in the same year. A radio maker who paid \$400,000 for space also reimbursed his dealers \$1,500,000 for local newspaper runs, but, in order to get the radio properly pushed, made "allowances" greater than the total of these sums.

Four manufacturers of prominent products, each known to spend more than \$1,000,000 a year for space alone, pay out annually more for "allowances" to chains than for all other forms of space, dealer helps, and 50:50 for local newspapers.

The four may well be forty, and if the truth could be known probably there are 400 that do likewise in the less-than-a-million group.

